BEFORE THE

FEDERAL ENERGY REGULATORY COMMISSION

- -x

IN THE MATTER OF: : Docket Numbers

CONFERENCE ON COMPETITION IN WHOLESALE : AD07-7-000

POWER MARKETS :

- -x

Commission Meeting Room
Federal Energy Regulatory
Commission
888 First Street, NE
Washington, DC
Tuesday, February 27, 2007

The above-entitled matter came on for conference, pursuant to notice, at 9:10 a.m.

BEFORE:

CHAIRMAN JOSEPH T. KELLIHER

APPEARANCES:

COMMISSIONERS PRESENT:

COMMISSIONER SUEDEEN G. KELLY
COMMISSIONER MARC SPITZER
COMMISSIONER PHILIP MOELLER
COMMISSIONER JON WELLINGHOFF

P R O C E E D I N G S

(9:10 a.m.)

CHAIRMAN KELLIHER: Let's take our seats. Why don't we close our doors?

(Pause.)

Why don't we close the doors in the back? Anyone who wants to continue conversations, you can go out in the hall outside. Isn't that how it's done in Congress? I think that's how you all used to do it, so we'll follow.

Good morning and welcome to the Conference on Competition in Wholesale Power Markets.

The fundamental duty of the Federal Energy Regulatory Commission in the area of electricity regulation, is to guard the consumer from exploitation by noncompetitive electric power companies. That is our core responsibility.

We have discretion on how to discharge that duty. Over the past 25 years, we've relied on two principal means to guard the consumer and assure just and reasonable wholesale power prices: One is direct regulation; the other is promoting competition.

Now, the Commission's policy is not and has not ever been deregulation. The Agency had never relied solely on competition to assure just and reasonable rates, and has never withdrawn from regulation of wholesale power sales.

The nature of our regulation has changed over time, of course. While we used to control the exercise of market power by setting rates for individual sellers, we now establish general market rules, market power rules, and enforce those rules through the exercise of our new enforcement powers Congress gave us in 2005.

Now, some persist in the view that regulation and competition cannot coexist. They argue that the Commission must go down one path or the other, and, personally, I reject that notion.

Nearly 4 years ago, the great economist, Alfred Kahn, observed that, quote:

"The two principal institutions of control in a private enterprise economy are competition and direct regulation. Rarely do we rely on either of these exclusively. No competitive markets are totally unregulated, and no public utilities are free of some aspects of rivalry. The proper object of search in each instance, is the best possible mixture of the two."

I agree with Dr. Kahn. In my view, the central challenge before the Commission today, is finding the best possible mixture between regulation and competition in wholesale power markets.

Now, some of our panelists will doubtless argue that we have not found the best possible mixture, but none should doubt the Commission's resolve to do so. That is driving a lot of what the Commission is doing today.

It led us to reform our open access rules two weeks ago; it led us to pursue reform of our market-based rate program; it led us to reform transmission pricing; and led us to strengthen our enforcement program, and it led us to this meeting today.

Now, this conference is an important part of this process. The fact that we're holding this conference, shows that we have heard the criticism of stakeholders and market participants and that we take these concerns seriously.

It also shows that we recognize that there are challenges to competitive wholesale power markets, both the organized markets and the bilateral markets.

It also shows that we are not complacent, we are not resistant to change, and that we are not defenders of the status quo.

Now, while competitive markets face challenges, we should acknowledge that competition in wholesale power markets is national policy. The Energy Policy Act of 2005, embraced wholesale competition as national policy for this country.

It actually represented the third major federal law enacted in the last 25 years, to embrace wholesale competition.

Now, to my mind, the question before the

Commission, is not whether competition is correct national policy; that question has been asked and answered three times by Congress.

Now, if we accept that the Commission has a duty to guard the consumer, and if we accept that competition is national policy, I think the Commission's duty is clear: It is to make existing wholesale markets more competitive, and that is the heart of this review, to not only identify the challenges facing competitive wholesale power markets, but also to identify and assess solutions to those challenges.

Now, competition has existed in wholesale power markets for many decades, but it has steadily become a more important feature of our power markets over the past 25 years.

Now, at the outset of our review, I thought it would be useful to begin at the beginning, to discuss the origins of wholesale competition policy, and remind ourselves why this country committed itself to competition in the first place.

Now, to that end, we invited leaders from the early efforts to promote competition, to join us and discuss why this country turned towards competition, and later panels will identify challenges facing organized and bilateral wholesale power markets, and hopefully begin a discussion of possible reforms.

Now, the United States does have different wholesale market structures, and that will likely remain the case for some time. That means the Commission, as it considers reforms to make wholesale markets more competitive, must bear in mind those differences.

It also means we should consider reforms that are both national in scope, as well as changes that improve one particular market structure.

I ask panelists to give us your best ideas on solutions to the market challenges. As panelists propose ideas, I ask you to set aside jurisdictional considerations and to just give us your best ideas.

We know where the jurisdictional lines fall, and I, for one, am not interested in reaching beyond them.

We also know that the Commission has limited authority to address certain challenges. In some areas, states have more authority than the Commission, and if we hear good ideas that properly fall within state jurisdiction, we may recommend them to the states for their consideration.

I also do not necessarily think that all the challenges facing competitive markets, can be resolved by regulators, federal or state, and that some challenges may be best resolved by the industry itself.

I look forward to hearing your ideas, and I just want to emphasize that the Commission is a reform agency and that we are prepared to make reforms. With that, I'd like to turn to any of my colleagues and see if they have any comments they might want to make, any welcoming comments or other comments. Suedeen?

COMMISSIONER KELLY: Well, thank you, Joe. I think you gave a great overview, and I don't want to take more than 30 seconds, because I'm anxious to hear what the experts have to say.

I appreciate your being here. Thank you for giving us a look into the past and why we're here now, and, to the extent you have comments that you'd like to provide us on where you think the markets are going or where you think they need to go, I would certainly appreciate that.

CHAIRMAN KELLIHER: Commissioner Moeller?

COMMISSIONER MOELLER: Thank you, Mr. Chairman. I agree with your comments, and Commissioner Kelly's comments. I'm not quite sure if we're having a discussion or a debate or what, but I know, classically, if you're talking about a debate, you always agree on definitions of terms.

One thing I'd like to make sure of, is that if people want to use the word, "deregulation," they're welcome to read the 1200-page Order 890.

(Laughter.)

COMMISSIONER MOELLER: This is not a case of deregulation; this is a case of talking about competition, and the terms are important. Based on our Seams Conference in Phoenix, and how productive those discussions were over a couple of days, I'm looking forward to this series of conferences we have. I think they're a great idea, and I look forward to people's ideas and how we can make these markets work better. Thank you.

CHAIRMAN KELLIHER: Okay, thank you. Colleagues? Marc?

COMMISSIONER SPITZER: Thank you, Mr. Chairman. I have just a few brief comments, and I hope my colleagues will indulge this off-the-wall historical analogy.

CHAIRMAN KELLIHER: By all means.

(Laughter.)

COMMISSIONER SPITZER: Well, just wait.

(Laughter.)

COMMISSIONER SPITZER: I had read all the materials twice, and having hired expert witnesses during my career as a lawyer, I'm familiar with both sides, with the tussle of expert witnesses.

And then I recalled an episode from 25 years ago when I was a student in Italy, and it occurred in the context of reading a little article -- I did some fun reading last night. I read a little article on Churchill's speech at Westminster College in Fulton, Missouri, where he used the words, "An iron curtain has descended across Europe."

And it went into -- Churchill was ahead of his time in that respect, but, ultimately, we had NATO formed and there was a consensus that the Iron Curtain was not a good thing, and certain consequences of economic regimes in the Iron Curtain states persist.

This episode in Italy was -- I had a dispute at the department store, and Italian was my third language back in 1978, and I was having trouble. I have enough trouble in English, and I was trying to negotiate a resolution of my purchase at the department store.

There was a little piano on the second floor, and there was a 14-year old kid who was playing the Communist International over and over and over and over on this little piano.

(Laughter.)

CHAIRMAN KELLIHER: How did you recognize it?

(Laughter.)

COMMISSIONER SPITZER: I did.

(Laughter.)

COMMISSIONER SPITZER: I'm an eclectic; I'm an eclectic person.

CHAIRMAN KELLIHER: I wouldn't have recognized it.

(Laughter.)

COMMISSIONER SPITZER: I did.

(Laughter.)

COMMISSIONER SPITZER: I will -- do we want me to sing it?

CHAIRMAN KELLIHER: No.

(Laughter.)

COMMISSIONER SPITZER: In Italian?

(Laughter.)

COMMISSIONER SPITZER: And I had to spend three hours negotiating the return of my -- or fixing of my purchase. And, presumably, this 14-year old kid was trying to recruit the people at the department store, to the Party.

And I don't think he was successful, but maybe his intentions were laudable. So, I guess I draw a couple of conclusions from that juxtaposition, as follows:

First, I'm not wed to the status quo. I'm fairly new to this Agency, as we all know, and there's a lot of history. The Chairman gave a very good elucidation of some matters before Congress.

I would prefer that we have a wide-ranging discussion, and, recognizing that we're limited in our authority, vis a vis the states and vis a vis Congress, I think it's good to explore everything, and I am not -- absolutely not wedded to the status quo.

That being said, the repetition of the Communist International for three hours, wasn't real helpful. And there weren't any solutions proposed, and so, rather than repetitions, I would like to hear some solutions.

And, in particular, you know, it was not entirely consistent with my own philosophy, but the Cato Institute from 2004, challenged some of my predicate assumptions and proposed solutions, and I'm interested in that type of methodology.

Secondly, the environment is a major issue, and one of the major benefits of the OATT reform Order 890, were the substantial benefits to the environment contained therein.

And although authority resides with Congress, the fact that a number of states, including my own, have adopted renewable portfolio standards, suggests that federal policy, regulatory, ought to accommodate, if possible -- if there are choices, ought to accommodate benefits to the environment.

And I would like some discussion of the concept of a command-and-control economy as to its benefits to the environment. The Oder River is a dead river in East Germany. The Iron Curtain's economic system was not particularly beneficial to the environment, and if you go back to PURPA, to me, that's a demarcation, that's an historical demarcation and a recognition that non-utility generation had environmental benefits, and I would like that pursued.

Thirdly, consistency. I am very interested in business entities taking consistent positions, and I think that's a laudable thing. Where a business suggests that competition is wonderful, except in their service territory, that strikes me as an inconsistency and I'd like that explored and discussed.

Finally, more off the wall, Stalin wasn't able to rewrite history. He tried, but he could not succeed. In the 1990s, I was in the state legislature, and I heard the arguments on the restructuring issue, and the arguments that the competition model was valuable, in and apart from the issue of whether rates were high or low.

The argument brought by consumers in my jurisdiction, was, the old model -- and we had an over-build problem in the 1980s and there were economic issues, but there were also environmental issues, and that model was not beneficial and that changes should be made.

And I heard that in the course of preparing for my campaign for the Arizona Commission. So, I'd like some exploration of whether there have been attempts to rewrite history, but, again, Mr. Chairman, I am not wedded to the status quo; I'm looking for proposals to change, where appropriate, to benefit consumers, and thank you very much and I look forward to this discussion.

CHAIRMAN KELLIHER: Thank you, Marc. Jon?

COMMISSIONER WELLINGHOFF: Thank you, Mr. Chairman. First of all, I'd like to thank Michael Bardee and Moon Paul of our staff, for providing this fine briefing book. I did read it all.

Luckily, I had a long plane ride over the weekend, that allowed me about ten hours of reading time, so that helped me get through it.

But, you know, I look at my interest in the examination today, not so much in competition, the issues of competition or regulation or deregulation, but really in the issues in the efficiency of the delivery of electric services.

I think that's what we're all here about, and what Chairman -- what Commissioner Spitzer said, as well, and that is, ensuring that that consumers get the most benefit and the most benefit from the electric services that are provided to them.

And I think that can be done through two things: One, maximizing operational efficiency on a day-to-day basis with respect to how the system operates, and, number two, maximizing dynamic efficiency, which is that investment going forward with respect to the choices that we have to make between transmission, supply-side generation, and the demand side, and ensuring that we make the wisest, and, hopefully, most efficient and economically beneficial choices.

So that's really what I'm interested in exploring, and I do hope that we get some solutions and some discussion in that regard. One of the papers that I read here, I found particularly interesting, and that was by Dr. Eto of Lawrence Berkeley Laboratories, and let me just quote from Dr. Eto's paper, because I think it kind of gives you all a flavor of where I think we are right now:

> "FERC's policies regarding RTOs have wide-ranging impact on production, transmission, and consumption of electricity. Public policymakers want to know the direction and size of these impacts. The data and methodologies needed to inform policymakers, are incomplete. Some impacts can be estimated at this time; others will require some time to assess, and some may

never be estimated quantitatively. The approaches and data used in recent studies, enables us to begin to identify and prioritize needed improvements in data methods."

I think we really are starting this journey of determining how we set up metrics to quantitatively determine whether or not we are going down the most efficient path, and that's really what I'm looking for. Thank you, Mr. Chairman.

CHAIRMAN KELLIHER: Thank you. With that, I'll recognize the first panelist, and that's Dr. Paul Joskow, Massachusetts Institute of Technology. Paul?

MR. JOSKOW: Mr. Chairman and members of the Commission, thank you for you --

CHAIRMAN KELLIHER: Is your microphone on, Paul?

MR. JASKOW: Oh, sorry. Thank you for having me here today. Fred Kahn was my undergraduate advisor, and the first FERC hearing I attended, was when I was 16, so I guess I'm on the right path.

(Laughter.)

MR. JASKOW: The competition and regulatory reforms that have been transforming the U.S. electricity sector, represent the last chapter of three decades of restructuring, promoting competition and regulatory reforms affecting many important sectors of the U.S. economy that were historically subject to price and entry regulation.

This includes, of course, the natural gas industry, where this Commission played a central role in reforming the sector, despite significant opposition from interest groups and even from some state regulators.

In some ways, the electricity sector has proven to be the most challenging sector to reform, both technically and politically.

Nevertheless, continuing the Commission's efforts to create well-functioning, competitive wholesale markets for electricity, will continue to yield significant benefits to the U.S. economy.

I urge the Commission to continue to support vigorously, the evolution of efficient wholesale markets.

Some will argue that we should return to the good old days of regulated, vertically integrated monopolies. The good old days were not nearly as good as some people seem to believe.

Many utilities had operating costs that were higher than best practice, experienced enormous construction costs overruns, exhibited poor generator availability, built units of sub-optimal scale, were slow to adopt new technologies, and exhibited persistent excess generating capacity.

The organization of the nation's transmission grid with nearly 150 separate control areas, poor coordination between them, and limited access to transmission service, led to inefficient utilization of the existing stock of generating and transmission capacity, increased the cost of meeting reliability, and created barriers to entry for independent power producers.

The bills for these costly inefficiencies, were sent to retail consumers, and the pressure for restructuring to support wholesale and retail competition, came from consumer groups, primarily large industrial consumers, who were tired of paying for the excessive costs of regulation, as well as from municipal utilities and independent power producers, who wanted to open up access to the grid, to competitive wholesale markets, where they thought they would be treated more fairly.

So, what's been accomplished in this odyssey over the last ten or 15 years? Here, I must distinguish between the organized markets in the Northeast, the Midwest, and Texas, from the rest of the country, where they continue to rely primarily on regulated, vertically integrated monopolies.

In my view, the markets in the Northeast and

Midwest, organized around an LMP model and managed by an independent system operator, now work very well.

These markets are extremely competitive under almost all contingencies. The wholesale markets for energy and ancillary services, are highly transparent, support more efficient generator dispatch for energy and operating reserves, and facilitate entry of new generating capacity.

Scarce transmission capacity is allocated fairly and efficiently. Wholesale market prices reflect the marginal cost of generating electricity over time and location, including the costs of congestion and losses, except under extreme scarcity conditions when they are still too low, for a variety of reasons.

These wholesale market prices are the foundation for stimulating good demand-side response programs and providing good incentives to consumers to use electricity wisely.

Significant progress is being made within the ISOs in deploying well-designed demand-side programs to reduce the need for new generating capacity, to help to meet reliability criteria efficiently, and to use the existing fleet of generating plants more efficiently.

Generating unit availability has improved, especially for the deregulated nuclear plants, that is, economic deregulation, and non-fuel operating costs have declined and heat rates for fossil plants have improved.

The organized ISO markets provide an effective platform to support renewable energy portfolio standards that many states have adopted, and also provide an excellent platform for implementing cap and trade systems for SO_2, NOX, and, potentially, for CO_2.

The introduction of the new capacity markets and capacity payment mechanism in New England, solves what was a significant problem in energy markets under scarcity conditions, and is stimulating a renewed activity in generation investment.

The evolution of robust transmission investment planning processes, especially in the New England ISO and PJM, are now supporting needed investment in new transmission capacity.

There are still things that need to be done in the organized markets, and my first message is, do no harm. The Commission should resist efforts to make dramatic changes in the organized market designs in the Northeast and Midwest.

Drastic market design changes will not lead to lower wholesale prices. Wholesale prices have risen significantly in the last couple of years, because deregulated natural gas and oil prices have risen even more dramatically, not because of wholesale market design failures.

That's who markets work. As fuel prices come down, wholesale electricity prices will also come down, and they already are coming down in New England.

Continue to support the ISO's implementation of robust demand-side programs, including more use of priority rationing contracts, distributed by scarcity prices, rather than administrative reliability rules.

Continue to support well-design capacity obligation and supporting capacity in operating reserve market mechanisms, such as those that exist in New England, New York, and are proposed for PJM.

Turning now to the rest of the country, where there are not organized wholesale markets and where there are not ISOs or RTOs, it seems to me that now that the Commission has reformed Order 888, all 1200 pages of it, it should turn its attention to reexamining and implementing key provisions of Order 2000.

And I give the highest priority to the following: All transmission-owning utilities should be required to join a regional RTO or ISO that meets the kinds of criteria for independence, geographic scope, and provision of wholesale services that are specified in Order 2000.

The details of those market designs can vary, but having an RTO is important.

High-voltage transmission service should be fully unbundled and subject to Commission rate and service quality regulation. All buyers and sellers of power in the same area, should take service off of the same transmission tariff, under the same terms and conditions.

This is the only way that this Commission can regulate transmission rates effectively, and adopt good incentive regulation mechanisms that harmonize incentives to transmission services suppliers, with consumer benefits.

All buyers in wholesale markets need to have -- all buyers and sellers in wholesale markets, need to have access to transparent, competitive balancing markets for energy, whatever their design; transparent competitive markets for ancillary services; nondiscriminatory, transparent mechanisms for allocating and pricing scarce transmission capacity; and the right to compete for short-term and long-term transmission rights.

There should be independent market monitors in each of these ISO or RTO regions, to monitor market behavior and performance, and to implement Commission-approved market power mitigation programs, where necessary.

At the present time, the greatest impediment to investment in new generating capacity, is political and regulatory uncertainty that is being produced by calls for re-regulation and calls for altering, dramatically, wholesale market designs that are involved in positive directions and work quite well.

Accordingly, I urge the Commission to reaffirm its commitment to competitive wholesale electricity markets, and its rejection of calls to redesign dramatically, yet again, the organized markets in the Northeast and the Midwest, that work quite well. Thank you very much.

CHAIRMAN KELLIHER: Thank you very much. I'd like to now recognize the Honorable Phil Sharp, former Chairman of the House Energy and Power Subcommittee and one of the authors of the 1992 Act, and currently President of Resources for the Future. Chairman Sharp?

MR. SHARP: Thank you very much, Mr. Chairman. I'm delighted to be invited back. Frankly, as a former Congressman, I'm delighted to be invited anywhere.

(Laughter.)

MR. SHARP: But I'm here in the capacity of a recovered politician, and you asked me, in particular, to speak to some of the history and why we believed what we believed when we did, and why we acted upon it.

I must say that I have to issue a caveat, that while we have researchers at Resources for the Future, who do a lots of work on the electricity markets, and especially on design of cap and trade systems and CO2, I'm not speaking on their behalf, they will be happy to know. I am here to speak from my experience with this issue.

Let me return to 1992, just for a moment, if you will. There isn't a lot written about what people said and thought at the time, and, in fact, I returned to the Committee Report of the House of Representatives, just to identify what the obvious purpose was, just to remind people of the 1992 Act, and it was to promote more competition in wholesale markets, period.

And the belief was that in doing so, we would achieve two beneficial results: One was to improve the general efficiency of the utility industry, and the other was to help secure the lowest possible cost to consumers.

People will dispute this, but, in my view, the first was unquestionably a major success. I don't think there is any question that competition, not just the result of 1992, but of various forces, radically reshaped the way this industry operates, the skill sets that we in management decisions, the efficiency with which power plants are run, with which transmission is used, referring to what Paul said, the general economic benefits of trying to use more effectively, what is a massive investment in this country in capital, and that the old system did not do it well, not that the new system does it so perfectly.

But in my own experience on a board of directors consulting with others, I witnessed, anecdotally, as many of you have as well, enormous internal changes, many of which were quite beneficial -- not all of them, obviously, but many were.

The second part of that is a little more difficult to know for sure, whether we got the lowest possible cost for people out of the competition, to the extent we got it, but I think many studies will argue that that is the case, and while the record may be spotty at different times in different places, that is the general direction.

Let me suggest to you, as the report indicates, that this came on the result of after ten years of experience with PURPA. And you will recall that PURPA was in 1978 -- and I was involved in that, as well -- was designed to encourage renewable power and co-generation, primarily, but it had the unintended consequence of letting us see that, in fact, independent power generators could operate and the system could remain reliable.

And people forget now, how much the argument was in 1978, that you could not reliably operate without monopoly control. That simply was not feasible and not smart to do, and it took a lot of experience and a lot of guts to break that concept back at that time.

Some people seem to think that the return to monopoly power, in total, will somehow improve some of these situations. I doubt it.

We also found that the state governments, in trying to impose -- or trying to deal with the question of avoided cost under PURPA, of course, came up with some very innovative propositions, including bidding systems, which not only helped, in particular, with the new purchases, but it really set benchmarks and ways of trying to get at what the regulatory system had always struggled with, which was how do you supervise the costs on a massive scale, of a big project, and is there any hope that you can do that with great competence and skill in a regulatory system?

And there are many doubts about that, and some people would like to return totally to that system. They might recall that it did not give all the protection that investors had hoped for, because the political consequences of putting it all on the ratepayers, once they begin to feel the excesses that were alluded to by Paul, of course led to a political backlash, which then led to so-called prudence reviews, which led to many utility investors saying, whoa, wait a minute, what happened to the regulatory compact that protected our investment? It seems to have gone out the window.

So, neither the consumers were totally satisfied with the protection, and, by the way, neither were the investors totally satisfied. This is not to say it's all wrong; it's simply to say let's be careful about any assumption about how effectively that worked, and I think that's relevant.

I just want to make one other general comment about what we were dealing with at the time, which, again, slips people's memories, and that is that we had been through what we called "stagflation" in the '70s, stagnation in the '80s.

We had an economy in which we were hand-wringing continually about whether we could compete with the Japanese and with others, and multiple things, I'm sure, are responsible for why we ended up being more effective competitors, both at home and abroad, but part of it clearly was a design to try to reduce economic regulation and to inject more competition throughout the system, and become more effective competitors, which, in fact, our economy did to the great benefit to us and to our international leadership.

And let me just suggest to you that we have had difficulty making that work in electricity, but this is an industry that must be dynamic, if we're going to have a digital economy that's successful. This is an industry that uses huge amounts of capital and must be effective, and so we want to be very careful, if we think we're going to shut out the possibility for the pressures of competition to help discipline those investments, help encourage innovation, and bring that about.

I didn't mean to come to totally preach, but I just am struck by one comment that was made when restructuring was going on, by a senior executive of a major utility. It's in one of the states that restructured, and pushing the generation aside, and what they did, was that they announced that they would remain the wires company and they would sell off the generation.

And the announcement literally said it's because our strength in this company is dealing with regulators and legislatures. As a legislator, I was not complimented.

(Laughter.)

MR. SHARP: I don't think that is the main goal of an electric utility system, that that should be one of its strengths. It may need those skills, but that is not where the focus should be.

I realize that this story somewhat overstates the case, but let us not forget that we need to look beyond just monopoly as the solution to the problems here.

Well, my time is about up, Mr. Chairman, so I will just add one other point: In 1990 Clean Air Act, to Mr. Spitzer's comments and others, in the 1990 Clean Air Act, we already, predating 1992, recognized the importance of independent power, and so when the SO2 program was designed, it put in a fail-safe provision to make sure there was a way that credits could be gotten by independent power producers, to purchase them from the Federal Government, in case they couldn't buy them in the market.

It turned out we didn't need that, but the fact was, it was already clear in the minds, that for environmental reasons, as well as for economic efficiency reasons, there was a need to shake up the system, and, of course, we did that.

All the way through, this has been bipartisan. It was in 1992; it was in 1978; it was in 2005. This Commission has undergone Presidential changes and majority party changes, and I believe that it is very clear that there is a strong commitment in this country to trying to make wholesale markets competitive, and I wish you well as you continue that.

CHAIRMAN KELLIHER: Thank you very much. That's perfect timing, very impressive.

(Laughter.)

CHAIRMAN KELLIHER: I'd like to recognize the Honorable Linda Stuntz, former DOE Deputy Secretary, one of the authors of the national energy strategy, one of the principal authors of the national energy strategy, which led the Energy Policy Act of 1992, and currently one of the founding partners of Stuntz, Davis & Staffier. Linda?

MS. STUNTZ: Thank you, Mr. Chairman, and thank you for the privilege of appearing before you all on this very important subject.

Let me simply cover and agree with what's been said about the good old days not really being that good. The regulatory compact was fraying as a result of nuclear cost overruns and other cost overruns.

I might have a slightly different take on the -- I don't believe PURPA was quite the unqualified success that maybe Mr. Sharp would have said, but it certainly demonstrated the possibility of independent generation playing a role and competition playing a role, a beneficial role.

Let me turn to, in fact, what went right, why I believe competitive wholesale markets, why Congress has continued to support competitive wholesale markets.

They have produced benefits for consumers. The vast majority of generation constructed since 1990, as you all know, has been constructed by non-utility generators. They and their shareholders and lenders, have borne the risk of missed demand estimates, missed projections of fuel prices, that utility ratepayers bore before the 1990s.

And as the experiences of Calpine, Mirant, and others have shown, those risks are not trivial. So that's been a good thing.

In addition, as Mr. Sharp suggested, competitive wholesale markets have spurred greater productivity and efficiency in the generation of electricity. As part of my homework to appear before you today, I spoke to some folks, did some research, and, in fact, between 1990 and 2005, U.S. nuclear power plant output increased from 576.9 billion kilowatt hours, to 782 billion kilowatt hours.

That's the equivalent of 26 new 1,000-megawatt power plants, which, of course, you know have not been constructed in this country. But what that really means, is their capacity factor has gone up dramatically from about 70 percent to nearly 90 percent, and there have been incremental expansions of the existing facilities, based on new technology enabling them to make some bolt-ons, that know Mr. Rowe could speak more eloquently on.

But I think that's striking, and I believe that is the kind of system efficiency, if you will, that's a product of the market.

Coal plants as well, the capacity factor has increased from 55 to 60, which doesn't sound like a lot, but when you consider the enormous base amount of generation that we have, that is a significant improvement, and that is, again, just merely in the capacity factor of existing plants, so that benefits consumers.

There are three important things, however, that have not gone, at least speaking as one policymaker expected, and they are important.

The first is natural gas supply and price; the second is transmission investment, and the third is generation supply.

Natural gas supply and price -- and I would expect most of this panel will recall that there was an orthodoxy, if you will, in the mid- to early '90s, that there was almost an inexhaustible supply of natural gas available at $3 or less.

There was a famous professor from the University of Texas who espoused this, and the notion was, we were going to continue to invent new technology that would enable us, there was a tremendous gas resource base out there and it was not really ever going to go above $3.

Well, that appears to be wrong.

(Laughter.)

MS. STUNTZ: Now, I say "appears," because, of course, our history of predicting prices, has not given one great cause for confidence, however, I've had the opportunity, again, in my private life, to work with some of the great service companies in the world, and I've looked at the data.ta.

And what I would like you to know, because it informs decisions that I make, is that fully 50 percent of the natural gas being produced in this country today, is from wells drilled in the last three years. Even with the tremendous amount of drilling activity that has been elicited by these high natural gas prices, we are barely able to keep production constant.

Meanwhile, imports from Canada are declining, because they, themselves, are faced with a maturing resource base and with their internal consumption needs. So this is a physical reality that we have to take into account going forward.

It is surely one of the reasons why we see natural gas prices where they are today, and surely is a very different scenario than was forecasted, when, in fact -- I think that most folks, at the time of the Energy Policy Act of '92, expected natural gas generation to strand a lot of existing coal and nuclear generation, that is, in fact, not what has happened; it's turned the other way around, which prompts me to make a recommendation, which I can hopefully get to before the end.

The other issue is transmission under-investment. This Commission has spent a lot of time on this, and I know you're aware of the numbers.

I believe there is -- the simplest explanation is that when integrated utilities stopped building base load generation in the '80s, they stopped building big new transmission projects, and what you build to interconnect new generation and when you're just building natural gas plants, you don't build a lot of base load transmission.

There are more elaborate explanations than that, but that's it. Electricity policymakers in the '90s -- and I had this view -- were very much influenced by the natural gas model, that we would continue to build transmission in a competitive wholesale electric market, just like we were continuing to build natural gas pipelines in the competitive natural gas wellhead market.

But that hasn't been right, and I think there are at least three and probably four reasons for that: The economic incentives of the transmission owner to benefit its own generation, which I believe this Commission has taken tremendous steps to resolve and I actually believe is less of a factor today, because of what this Commission has done and because of the way the market has evolved;

The difficulty of siting transmission lines, which Congress and you are dealing with on corridors; the challenge of transmission rate design, which remains a challenge unresolved. It's quite difficult, and I might have to disagree a bit with Paul on this.

Fourth, the role of states in regulating transmission rates, is a role that they do not play with respect to interstate natural gas pipeline rates, and I know it's a sensitive subject, but I believe it is time that it needs to be addressed.

Without adequate transmission, the promise of competitive wholesale markets, simply cannot be achieved. Congestion, market power, and the opportunities for market manipulation, are products of inadequate transmission.

You can try and police those as symptoms, and you're doing that as effectively as I think you can, but the answer is to get more transmission.

There is also a concern about adequate generation. We seemed to have more than adequate generation until the collapse of Enron, however, with that, we've lost a lot of the financing mechanisms that were pioneered by some of the independent power producers.

I applaud the renewal of the FERC/NARUC dialogue on resource procurement. I think basic questions have to be asked, including in organized markets, about who is going to build generation, what are the decisions that are going to be made, and how will it be built, and how will the costs be recovered?

That leads me then to the three recommendations: Given the volatility and level of natural gas prices, I would encourage FERC to consider whether single-price auctions for electricity are appropriate, or whether some other mechanism, such as as-bid auctions, could provide greater benefits.

In this, I suggest adding to what the distinguished economists recommend, a dash of the practical and the equitable.

Secondly, I have reluctantly, but firmly believed that FERC needs to exercise its rate authority, not conditions and terms, but rate authority over transmission in interstate commerce, as confirmed in New York v. FERC, for the transmission component of bundled retail sales.

I believe that as long as 90 percent of the transmission rate base continues to be regulated by states, in effect, your efforts to encourage transmission, that Congress directed, are essentially, as I put in my statement, are going to be like trying to wag the dog with the tip of its tail.

Finally, I believe, as part of the resource procurement dialogue with NARUC, FERC should explore with states and large consumers, mechanisms to encourage long-term contracts, and provide market certainty, sufficient to enable investment in new resources, particularly in areas with retail access where it is very difficult for long-term contracts to be signed that would enable more investment to be financed.

I have a couple of suggestions, including a California program, that might provide some lessons learned.

It seems like it might be working.

I look forward to your questions, and thank you again for this opportunity.

CHAIRMAN KELLIHER: Great, thank you very much, Linda. I'd like to now recognize the Honorable Bill Massey, former Commissioner at FERC and former Chairman of FERC. I want to make sure you get that proper --

MR. MASSEY: Mr. Chairman, finally the respect I so richly deserve.

(Laughter.)

CHAIRMAN KELLIHER: You've got it, you've got it.

(Laughter.)

CHAIRMAN KELLIHER: There was remarkable regulatory stability during your term as Chairman.

(Laughter.)

MR. MASSEY: It was a heck of a weekend, Mr. Chairman.

(Laughter.)

CHAIRMAN KELLIHER: With that, we look forward to your comments.

MR. MASSEY: Mr. Chairman and Commissioners, thank you for inviting me back for this conversation on a subject near and dear to my heart -- competitive markets for electricity.

I would like to cover three topics: What problems were the markets designed to deal with?

Number Two: What are our successes, what are some disappointments?

Number Three: What about the future of markets in this country? How can markets help us achieve the national goals of both political parties -- it's bipartisan -- for technological innovation or renewable resources, demand resources, efficiency, climate change goals, environmental values, and, in fact, greater energy independence?

Now, when I started as a Commissioner in 1993, we at the Commission were concerned, as was Congress, about operational and other inefficiencies under regulation.

Plants were operating at low capacity factors, more efficient non-utility generators were facing huge barriers to entry, yet customers were often bearing the risk of large cost overruns, as expensive plants came online and were put in rate base. There was almost no customer choice.

Municipal utilities and rural electric utilities, the so-called TDUs, were often trapped inside large utility systems and could not shop for cheaper or more efficient suppliers, and neither could the large industrials, for the most part.

Individual purchasers of power were apply to FERC for transmission access, but they faced litigation, delay, and frustration.

We decided to move generically with Order No. 888, a landmark regulation under Betsy Moeller's leadership. We wanted to spur the somewhat embryonic industry of independent suppliers, which would bring new technologies such as combined-cycle gas plants, suppliers that would innovate, would have the incentive to operate more efficiently with no rate base, and so their investors would bear the risk of bad decisions, rather than the customers.

And Order 888 was very successful, yet, when we looked at the landscape following Order 888, there were still problems, problems of market foreclosure, transmission foreclosure; in other words, some could not reliably gain access to the grid or to the market, despite Order 888.

Customers and suppliers were faced with pancaked transmission rates, old fashioned contract path pricing; congestion was socialized; power markets were evolving into larger, regional markets, and we saw this, yet there were no regional institutions, no regional transmission planning or dispatch -- or little of it, for that matter.

To move towards solving these problems, we strongly encouraged the formation of new regional institutions called RTOs, that you're very familiar with, that would independently dispatch generation, provide transmission access, with no skin in the game, so to speak, so it wouldn't be biased toward any particular resources.

Now, in my view -- and I think my views are well known -- these institutions made sense in 2000, and, to me, they make sense today, and they provide a host of benefits.

First of all -- and these are the principal successes, and it's very hard to follow the witnesses that preceded me, because they talked about many of them: Transparency; locational price signals are published in real time. That is a huge improvement over the past; it's huge for efficiency; it's huge for demand resources.

Independent dispatch, independent transmission operation, means that all resources, demand resources, renewable resources, are treated equally.

More efficient dispatch over a broad region, regional sharing of efficiencies, seams and balkanization elimination, no pancake rates.

Four: Suppliers bear the risk of their decisionmaking.

Number Five: Efficient transmission pricing.

Number Six: Transmission investment and construction is, in fact, reawakening now, and you can see this in a number of the large markets.

Number Seven: Regional planning, which I know you incorporated a lot of these same features into Order

890, and,

Number Eight: More renewables, is, in fact, a huge success of these markets.

I want to refer you to a letter that Dr. Joskow, Dr. Kahn, and a number of other economists signed to policymakers last summer, touting the benefits of markets. I think you have seen it. I'm going to put it in the record with my statement.

It's a letter to Chairman Kelliher in December, from large commercial customers of electricity, saying that they get huge benefits from these markets. Many of these are members of Compete, an organization that I represent. We have a number of customer members that very strongly support markets.

And then, finally, the AWEA letter that was released yesterday, showing that -- the wind energy letter, showing that wind resources are locating disproportionately in RTO markets. Seventy-three percent of wind resources are in RTO markets, where you would normally expect about 44 percent, based upon the wind availability.

So, there a great success. Disappointments? I think we need a great emphasis on competitive procurement. Others have mentioned that.

There is still a balkanized grid and inefficient transmission pricing in some regions, despite the

Commission's great efforts and good work, and I fear that there remain some opportunities for transmission foreclosure and market foreclosure outside the RTOs.

Outside the RTOs, I think we still need more reliable price signals, and, finally, I think both inside the RTOs and outside the RTOs, we need more of a focus on demand resources. I think it's a function of price signals, and it's a function of rules for the market being friendly to them.

They're certainly more friendly in the organized markets.

Now, how are we going to meet the needs of the future with respect to climate change, with respect to efficiency, with respect to renewables? How are we going to meet those challenges, as a nation, with respect to innovation?

My own view -- and we have some -- a good deal of evidence of this -- is, the best opportunities for renewable resources, in my view, will be in the large regional markets, for the reasons that the AWEA letter lays out.

Number Two: I think we need a greater focus on demand resources. To me -- I know you're very interested in this -- to me, the large regional markets are the place to go. You are familiar with the PJM example of last August 2nd, saving $650 million for their customers, relieving the stresses and strains of the system.

Number Three: Energy efficiency, both operational efficiency, which others have mentioned, and using electricity more wisely and efficiently, I can't imagine that these goals are going to be met in our nation, and that we're going to facilitate the kind of innovation that we now have the potential for, in the prices-to-devices world.

I can't imagine that, without these large regional markets, with good price signals, with good planning, with efficient dispatch, and I think the world is on the verge of opening up to a number of new resources that will be attracted to these markets, innovative resources, innovative technologies, that these markets will attract in the future. Thank you very much.

CHAIRMAN KELLIHER: Great, thank you, Bill. I'd like to now recognize John Rowe, the Chairman and Chief Executive Officer of Exelon Corporation. You have a very interesting background, that I think is going to help us.

You have lived under the old world, the cost-of-service world, the world that some want to return to, with some nostalgia, as well as the more competitive world, and also have pursued different corporate strategies in different wholesale regional markets, so I think you have a unique perspective. Thank you.

MR. ROWE: Thank you, Mr. Chairman. I believe that I am the longest surviving investor-owned utility CEO in the country.

(Laughter.)

MR. ROWE: And that gives me perspective on nostalgia and maybe even a little on economics. My task today is to talk about two to three decades of history in eight minutes, so as in the cartoon approach, some of the facts are actually in the footnotes, and I commend the prefiled materials to you.

But this discussion reminds me of the famous remarks of Lincoln Stephans upon returning from the Soviet Union in 1921. He said "I have been over to the future, and it works."

Well, I have been over to the past, and it didn't work very well, and I'm looking at the future, and it will only work if this Commission and state commissions show the consistency of purpose in evolving and refining a mix of competition and regulation that the Chairman stated at the outset of this hearing.

I began my CEO career at Central Maine Power, a 1500 megawatt company in the death throws of cost-based regulation of generation in New England. The particular crisis of the moment, was the Seabrook nuclear plant.

It was part of a national chain of early '80s nuclear plants that cost thousands of dollars per kilowatt, when their predecessors in the early '70s had cost only hundreds of dollars per kilowatt.

As one would expect, there was a great desire not to pay these costs, in spite of their many roots, which my colleagues here have described before. Indeed, the Seabrook plant cost more than $6 billion for one unit, and something like another billion or almost a billion for a second unit, which was not completed.

After much finger-pointing and much litigation much policy analysis, customers ended up paying about two-thirds of these costs; shareholders ate about one-third of these costs, and the Maine Commission affirmatively abandoned cost-based regulation for generation, to go some mix of implementing the PURPA Act and something that was called least-cost planning or integrated resource management.

This was similar to a great many other states, where, indeed, across the nation, something like $18 billion in construction investment was written off by utilities, and, again, at least as much, probably twice as much of relatively uneconomic capacity was paid for by consumers.

At this point in time, it simply wasn't considered a success. The new model -- I'll call it integrated resource planning -- proved equally troubled.

It was conceived that competition would be used to somehow provide amounts of electricity from types of generation plants, at prices that were determined, at least in part, in hearings before state commissions.

The initial such procedure used the Seabrook II costs as the avoided costs. One of my officers said we took the stupidest thing we ever did and were required to repeat it.

(Laughter.)

MR. ROWE: This multiplied throughout a number of proceedings, and the upshot was that when stranded costs were finally computed in places like California, three-quarters of the costs came from purchased power contracts.

It was about half in the Northeast, with the exact percentage varying from state to state, and almost 40 percent in some other regions.

I contrast this to the relative successes we have experienced in Illinois and Pennsylvania, successes that are facts, in spite of the current turmoil that exists over price increases there.

ComEd was another company that had overpriced nuclear plants. It also had operating problems. In '97, Illinois chose to go to competition, and it has seen much better results since. Over 9500 megawatts of new generation have been built, and not with customer responsibility.

Our nuclear operations have been sold. Half of the company's generation was sold to further competitive markets. My companies in Illinois and Pennsylvania, have put well over $3 billion into new transmission and distribution investments, and we're in the middle of a $350 million transmission project, as we speak.

The point I'm simply making, is that the competitive markets have worked and now that we are freed of price constraints, prices have only risen to a level a little bit below where they were in 1995, under the regulated model.

The key thing I'm reaching for, is that these competitive markets can deliver the kind of creative results that the prior witnesses have described, but they can only do it with consistency of purpose.

People ask why we're not buying more wind in Illinois or Pennsylvania? Give us confidence in the rules, and we can buy more wind.

Several members of this Commission have inquired, what it takes to get more demand management into the system. Well, I heartily endorse this.

We have gone beyond PJM's economics in doing demand management at ComEd in Chicago, as we speak, but we need to be sure that ISOs incorporate not only energy values, but capacity values and transmission protection values in demand management charges.

We need to make certain that state commissions include the values of protecting the distribution system.

There is, however, no doubt in my mind that a competitive market offers the best way in which to incorporate the large advantages of load-shifting and interruptible capacity, into prices.

In sum, let me say that I suppose that a rate-based model can work and I suppose that an IRM model can work and I believe that a competitive market will work.

But they all require consistency of purpose at a time when costs are rising. Today, they have risen for gas, they have risen for iron and steel and concrete. There are, in fact, labor shortages in various kinds of trades, and meeting the needs of our economy requires a level of creativity that is very difficult for either utility executives acting as central planners, or regulators acting as such planners. Thank you very much.

CHAIRMAN KELLIHER: Thank you very much. I'd like to now recognize Dr. John Anderson, the President and Chief Executive Officer of the Electricity Consumers Resources Council. John?

MR. ANDERSON: Thank you, Mr. Chairman, for the opportunity to be here today, although I'm beginning to wonder, as I'm listening to the my colleagues, if I'm going to be discussing the same market that they seem to be discussing.

(Laughter.)

MR. ANDERSON: I did remind John Moot, earlier, before this, that in the early '80s, when I first started advocating for competition, that I was much taller than he was, and I've lost an awful lot of stature since then, and I hope that I don't lose more today, but we'll try.

We have been probably one of the earliest in advocating competition. Our members operate in truly competitive markets all over the world, and we know what competition really is, and we feel that the defenders of the status quo today, who disagree with us, bear the burden of showing that there's real evidence that competitive power markets have actually arrived.

We believe that real competition would produce innovations, improve customer service in the so-called killer products that everyone wants and that we think would already have been delivered in truly competitive markets.

But the defenders of these markets today can't show us those things, because they don't exist. The old state regulatory regime, that at least had some end-use customer focus and rates based on average costs, has been replaced with a costly ISO/RTO federal regulatory regime that has no end-use focus and rates based on the highest accepted bids -- and I emphasize "bid," not costs.

You asked us on the panel today to discuss our expectations, and I'd like to cite seven specific expectations and four specific recommendations:

First, we expected a competitive market, and when end-used customers would both compete head-to-head with generators to establish market clearing prices, and that they're paid compensation equivalent to those generators, when load is reduced.

Unfortunately, this just simply hasn't happened. The results have been a few utility-implemented demand-response programs. I emphasize that it's important to say "programs," because they are not markets. Customers are not interacting with generation; they're interacting with the ISOs and RTOs.

While these programs certainly have some value as damage control measures for operational flexible customers against high clearing prices, they are not long-term substitutes for the level of demand response that we think is necessary.

Second, we expected the competitive market to stimulate new investments. There is an enormous amount of capital seeking new investment, but investment in generation has all but ceased in the organized markets, and transmission investment is not far behind in these markets.

Why? We think the day-two markets are not real markets; they are regulation without a rate base. Efforts to patch this huge problem with artificially centralized capacity constructs, are clear indications of market failures, and perhaps worse, these constructs aren't trusted by either generators, owners, or Wall Street.

This is no trivial problem, because we think that most of the benefits of restructuring were expected to result from the new long-term investments.

Third, we expected many new players to enter the competitive market, and so old, inefficient players to exit. This did happen on a limited basis, early on, and there have been, certainly, improvements in some efficiencies, as Mr. Rowe said, on nuclear power plants.

But, unfortunately, many of those that have bailed out lately, have been the new players, not the old, and the result is the old monopoly utilities with depreciated nuclear and coal assets, earning very, very healthy profits, while margin gas units are barely profitable and significant barriers to entry remain.

Fourth, we envisioned a market in which both suppliers and consumers would hedge commodity price volatility with long-term bilateral contracts. I appreciate Linda Stuntz talking about the need for long-term bilateral contracts.

This robust, liquid forward market created with these contracts, would provide investors with the same or better security as traditional utility rate base, but it hasn't happened, either.

Instead, for all practical purposes, consumers that need to hedge the commodity price risk, simply can't do so. Their choice is simple: Take the unbundled spot price, the highest bid clearing the market, or take a contract based on estimates of these same spot prices, bundled with a huge risk premium.

This is not a hedge and it certainly isn't the result of competition.

To add injury to insult, industrial customers are finding that the benefits of self-generation, perhaps the most reliable hedge in the past, are being taken away through premature repeal of PURPA, although we do thank very much, the Commission for working as hard as it has on the rule.

Fifth, we were early advocates of ISOs and the separation of operation from ownership of transmission. We hoped that the congestion costs, combined with the transparent, open-access operation of the grid by an impartial air traffic controller, would spur new investments, and this hasn't happened, either.

First, the pricing mechanisms, instead of providing investment signals to all those who own both generation and transmission, were not to build, while allowing them to continue to profit handsomely by protecting their inefficient investments.

Second, RTOs have not lived up to their promises as facilitators of long-term regional planning.

Sixth, we expected that industry restructuring would mitigate market power that was allowed, but hopefully addressed under regulation. This might have been accomplished, if the first five preconditions that I talked about, had been implemented, but it hasn't happened, either, and market power, to us, at least, is an even bigger problem as generators get bigger than before, because of structural features that we think would have been mitigated, and that has not taken place.

Seventh and finally, and after all these other conditions are necessary, we think that the wholesale price caps and bid mitigation -- we expected wholesale price caps and bid mitigation measures could be relaxed, because we think, at least, if we eliminate scarcity pricing from the equation, we cannot have any real competition.

The results of customers satisfaction surveys of large end users by a nationally recognized research firm, vividly show that the failures to achieve these expectations, has significantly changed the way that industrial customers view restructuring.

Specifically, for the last nine years, the customer service scores in regulated states, have been considerably higher than those in restructured states, for every factor measured in these surveys, and, worse, the gap is growing. I will include much more detail on this survey, in our prepared remarks.

And we are far from alone with these complaints, which, I think you are aware, are spread across a wide variety of segments.

Going forward, what should FERC do? I do offer four specific recommendations: First, FERC should acknowledge that the day-two construct is not working for the benefit of end-use customers, as required by the Federal Power Act.

LMP is not robust enough to compensate for inadequate infrastructure, and should never have been implemented without additional transmission and the elimination of major load pockets.

LMP will not work, unless enough infrastructure is in place to sufficiently mitigate the consequences of joint generation/transmission ownership of incumbent utility holding companies.

Price signals are clearly not stimulating and are probably discouraging new infrastructure investment.

Federal and state regulators do not share the same vision for the industry, which accounts, to a large extent, for a lack of demand response.

Second, FERC should initiate an inquiry into whether today's RTO platform with LMP, can be made a viable market model, and supported by consumers.

Are the necessary preconditions achievable and capable of delivering net benefits to end-use consumers? Can this platform address the problems such as inframarginal revenues, barriers to entry for new base load and mid-merit generation, siting problems for transmission, and so forth?

The outcome of this inquiry should be a new road map for either reforming RTO LMP format, or considering a return to regulation.

Third, FERC should acknowledge the magnitude of the problem and recognize that simple technical fixes or additional regulatory intervention, will not correct the inherent problems.

MS. PAUL: One minute.

MR. ANDERSON: FERC must be ready to substantially change the basic underlying structure and implement tariffs that provide customers with just and reasonable rates. Additional patches will not fix the problem.

Fourth, if conditions necessary to implement LMP cannot be achieved, the policy debate must shift to what form of regulation is appropriate for jurisdictional utilities -- state, federal, or a combination of the two?

Finally, recent judicial authority adds urgency to the Commission's analysis. We interpret the recent 9th Circuit decision in P&E and Snohomish, as extending way beyond the specific context of the Western market crisis of 2000/2001.

We think that FERC should assure that markets remain competitive to support a market-based rate regime, both under that decision and others of the D.C. Circuit's precedents, providing that market-based rates are just and reasonable, if and only there are competitive markets and an absence of market power.

Thank you very much for the opportunity to be with you today, and I look forward to your questions.

CHAIRMAN KELLIHER: Thank you. I would like to now recognize the Honorable Glenn English, former member of Congress and currently the Chief Executive Officer of the National Rural Electric Cooperative Association. Mr. English?y

MR. ENGLISH: Thank you very much, Mr. Chairman. I appreciate it, and it's a pleasure to be here this morning, and it's certainly a pleasure to be on the panel here with my former colleague, Phil Sharp.

I do remember in 1992 when Phil brought this bill to the floor of the House of Representatives, and at that time, we all hoped that competition would certainly bring with it, lower prices and better service, but that was true of about 20 years worth of deregulation, at least what we were told was deregulation in different aspects of different parts of the industry.

I voted for the 1992 Energy Policy Act, just simply because of the fact that I did believe that it was going to deliver that, and still have hopes that it will deliver that.

Electric cooperatives also supported the '92 Energy Act, and we did so believing that competition as far as generation is concerned, based on open access, would deliver benefits, not only to electric cooperative members, but to the country at large.

And as the Chief Executive Officer of NRECA, I can tell you that electric cooperatives continue to support this goal, and we assume that it can be obtained and benefit all consumers, as promised.

Now, let me say that I'm not here today to say that the markets have failed and that they must be abandoned. I don't think that that is necessarily true.

I just don't believe that the truly competitive markets have been fully developed. We haven't reached the promised land yet, Mr. Chairman, and together, we've got to continue to move forward and try to achieve that objective.

Certainly, the Order 888, as well as the 1992 Energy Act, still move us in that direction.

Mr. Chairman, I know that you have recognized that much needs to be done, and that certainly is the case, and that, I think, is manifest in the Commission's new Order 890. That's a huge attempt to improve open access, since open access began more than a decade ago.

The Commission's continued commitment is demonstrated by today's conference, and I want to commend the Commission for holding this meeting. I think it's certainly extremely important.

But I want to also say a few words about our cooperative principles here, and that gives us a little different perspective, I think, of where we come from, as perhaps others.

As you know, we're a not-for-profit organization owned by the members themselves, and we are strictly a consumer-owned, consumer-controlled type of business model, and what we do, of course, is aimed at strictly benefitting the consumers that own us.

Anything that does not benefit our members in the long term, of course, we do not support; we're opposed to it.

Our organizational goals are simple and clear, and that is to provide long-term, reliable, low-cost, non-volatile power supply to meet our members' needs and the needs of the local economy.

We should keep this in mind, I think, as we move forward and embark on what some have described in the past as being the grand experiment.

I also might say that we actually generate about half the power that we use, but we also depend on the market to produce the other half, so we're very dependent upon a competitive wholesale market to benefit our membership overall.

It is also important to recognize that while we need to buy power short-term, we need to also have contracts that will dictate long-term bilateral arrangements and make it possible for both long-term affordability and stability for our markets.

I also want to point out that we serve an area that's roughly 3/4ths of the geographic area of the United States, so most of rural America is served by rural electric cooperatives and certainly the 40 million consumers that we serve, live in that area.

These are resource-rich areas of the nation, and today, as we look to the future and talk about climate change and the importance of renewables and what role they can play, I think it is important to understand that most of those renewables, most of that renewable energy, will have to come from rural America in areas served by electric cooperatives.

I've had the pleasure and the honor for the last year or so, to work very closely on the steering committee of a group that has as its national objective, 25 percent renewable energy by the year 2025. That's certainly a very ambitious project.

As we have focused on the aspect as it deals with electric utility power and how we can provide electric power through renewables, it has become very obvious that transmission is going to be the key to fully realize the potential of developing what, in effect, would be a new industry in rural America.

To provide renewable power, it will be necessary, obviously, to get that power to the areas of the country, particularly the more urban areas of the country, and transmission is extremely important.

As it stands today, we fully understand that any renewable power, as it applies to electricity, is pretty much doomed to remain in the regions in which it's produced. We simply cannot move it out of rural America, so it is extremely important, I think, as this country moves forward and talks about climate change, dealing with the challenges that we must face there, that if electric power is going to play an important role, if we're going to move toward the objective of having 25 percent renewables by the year 2025 in the electric utility industry, the problems of transmission must be solved.

And just as the promises and commitments that were made nearly 15 years ago, well, with the 1992 Energy Act and delivering those wholesale competitive markets and all those benefits that those of us in Congress who voted for it, thought it would deliver, it is critical that we understand that transmission is the limiting factor once again.

MS. PAUL: One minute.

MR. ANDERSON: So I would hope, Mr. Chairman, that the Commission would focus, not just on what the challenges are today and where we may not be as effective and as efficient as what we had hoped 15 years ago, and certainly recognize and understand that we need to continue to chip away, that we must have an eye toward the future, and understand that we must solve these problems, that we must, indeed, hook this country up, if, in fact, we're going to address the challenges of the future, particularly as it applies to climate change. Thank you very much, Mr. Chairman.

CHAIRMAN KELLIHER: Thank you very much, Glenn. I'd like to now recognize Michael Skelly, with Horizon Wind Energy.

MR. SKELLY: Thank you very much. I'm speaking today on behalf of Horizon Wind and the American Wind Energy Association.

Thanks for the opportunity to talk about this very important and interesting topic. I want to start by thanking the Commissioners and Commission Staff for Order 890, the recent final rule to help eliminate or reduce imbalance penalties, and to make more available, conditional firm transmission services.

Those are both advantages or products that will help us get more renewable generation on the system.

And as -- the topic of the panel is history of deregulation, and as many of you know, wind began a renaissance in the late 1990s. That's when our company started to get involved in wind generation.

We had an interesting case when one of our first two projects were built in western Pennsylvania. At the time, we connected through a coop to Allegheny's system, and this is in 2000, and we couldn't see a way to get the project done, because Allegheny, at the time, was not part of PJM.

And because Allegheny wasn't part of PJM, our intermittent generation, as you know the wind -- we generate when the wind blows, and when it doesn't, we don't generate. We were subject to imbalance penalties, which basically rendered these projects impossible.

But Allegheny then joined PJM in late 2000, and that eliminated the imbalance penalties that we would have been subjected to. We went on to sign an agreement with -- actually, with Exelon, clear on the other side of the state, and we were able to get those projects built, because the market rules were put in place to accommodate a generator like us.

We were able to move -- at the same time we created renewable energy credits, which Exelon used to serve voluntary markets that were coming about at the same time in Pennsylvania and in other adjacent states.

Today I'm presenting a letter to the Commission from 22 renewable energy providers and environmental organizations, including our company, PPM Energy, The Natural Resources, Defense Council and a number of others. The letter makes the following points. That we believe that well-structured, wholesale electricity markets operated independently will allow for greater amounts of renewable energy and demand response resources to be integrated into the nation's electric grid.

Seventy-three percent of wind generation is now located in such markets and as was pointed out, only 44 percent of the wind energy potential is located in those same markets. We believe that the markets that we've seen develop -- the wholesale markets that we've seen develop over the last few years these are helping to eliminate Pancake transmission rates. They're providing energy markets that were variable and intermittent resources like wind can readily sell our products.

One of the big advantages of these markets is that, as we selling into larger control areas, there's a much great ability for those control areas to absorb the intermittency of generators like wind. And perhaps it's helpful to talk about a few examples of some of the things that we've seen over the last few years. We built and just brought online the last few turbines for our 320 megawatt project in upstate New York with our partners, PPM Energy and that was, in our mind, our interesting example of the full suite of things that wholesale markets have brought to bear that helped make that project happen.

We sell our -- much of our electricity is hedged in financial markets. Okay. So we go out. We get a hedge from a financial player who can help us deal with the long-term -- help provide us with long-term price certainty. Some of the electricity we sell into the New York ISO, day-ahead market, some of it's sold in the real time market. Some of our renewable energy credits are sold into the New York RPS program, which is run by NYSERTA and some of our renewable credits are sold into New York voluntary markets. So it's a very interesting example of the full suite of things that wholesale markets have brought about.

In other parts of the country, we still have challenges. For example, in Montana, where we were working on some projects, we don't have the mechanisms or the market mechanisms in place that would allow us to go ahead and get our projects built.

To talk about some of the challenges that we face. Today the U.S. wind industry has about 11,000 megawatts. In 2007, we'll see around 4000 more megawatts brought online. But we are doing the easy wind projects first. We're doing them in the markets that I talked about before and we're doing them in areas where we have fairly ready access to transmission. One of our biggest concerns is that we don't yet have in place and we worry about the coming about -- and just to build on your point, Glenn -- of the transmission mechanisms or the market mechanisms or some sort mechanisms to see that transmission gets built. We're seeing good action at the state level. Some of the efforts underway in Colorado, Wyoming -- the competitive real wind energy zone process in Texas. Those are all promising signs, but one of the other panelists referred to her concern about transmission and one of the missing things is we don't have sort of a monolithic protagonist that was the innovative utility that saw to it that transmission got built.

MS. PAUL: One minute.

MR. SKELLY: And we worry about the connecting of these very important resources, these very important wind resources that we have around the country and how are we going to get those to market. That's a big challenge for our industry and we think it's a big challenge that we need to overcome to help renewable resources to play a bigger role in addressing some of the issues that we're facing.

And then to very quickly close, on the wholesale market side, it's very interesting the way we think about our markets. We have to buy equipment two, three years in advance and one of the things that we do, as we order equipment, we make sure that we have enough projects in place in wholesale, competitive markets that if the need comes about we can build in those markets and we always make sure that we enough homes in those markets and we pair that up with bilateral markets, if you will, where we're selling to an end-use customers because we know that we can get our projects done in wholesale markets whatever comes about. And that's a very important thing for us to know in our industry when we're making these long-term capital commitments that allow us to keep the industry going.

Again, big challenges in our view. We need really sort of more of the same in many parts of the country. We're concerned about transmissions and we're just scratching the surface on wind. We'll have 15,000 megawatts by the end of the year, but we need to do a whole lot more. I think people expect that of our industry and we and the other companies in our industry we're willing to step up to the plate and do what we can to help bring these changes about. Thank you.

CHAIRMAN KELLIHER: Thank you, Mr. Skelly.

We are a bigger commission than we used to be a year ago, so I think we need to have a clock on us to use our time efficiently. I'm not really a math guy, but I think five times six equals 30 and we either live by six minutes each or we blow off the break. I think we should stay with six minutes each so we can get a short break and be fresher for the next panel. So why don't we go six minutes each and you are authorized to cut me off savagely when I approach my time.

We certainly should all fee free to submit written questions to this panel and other panelists at the end of the day. So I'm going to start my first question, so you can start the clock now. Thanks.

(Laughter.)

CHAIRMAN KELLIHER: One question is really what is the proper measure of the success of wholesale markets. Some people would argue that it's the movement of retail prices, but retail prices, of course, are primarily influenced by movement of fuel prices. And if you were to take a regulated state where there is no retail competition, a hypothetical state that relies very largely on natural gas for the electricity sold in that state and you took another state that's in a competitive market, open retail markets, relying to the same extent on natural gas you might see the very same movement in retail prices in those two states.

But if the movement of natural gas means the competitive market has failed, it seems, by the same logic, it means the regulated market has failed to the same extent. So that doesn't really seem to be the right measure of whether wholesale markets are working. So that creates a more complicated question. What are the right measures? Some of what you said suggests some measures. Based on what you've said today one measure is risk. Who bares the rise in a competitive market versus the old days of regulation? In the old days of regulation, it seems the ratepayers really bore virtually all the risks. In a competitive market, the market participants themselves bear risks.

Another is technology. To what extent does a competitive market do a better job producing, deploying newer technologies? It seems we've seen a lot of older coal plants shut down and less efficient generating facilities shut down during competitive markets. So perhaps that's a measure of the success of -- one way to measure the success or lack of success of competitive markets.

Another is efficiency. We've heard some of the panelists talk about that nuclear plant performance has increased dramatically during the competitive era when it was not increasing much before the competitive era. Another would be open access. To what extent is there greater access to the transmission system? And also market access, greater access to markets in the competitive approach versus the regulated approach; adequacy of supply -- another thing the panelists have raised. Does the competitive market do a better job or a worse job assuring adequacy of electricity supply?

And finally, reliability of service or quality of service. Which produces a more reliable system? I think based on the panelist discussion those seem to be really. Well, let me pose this in a question rather than a statement. But let me start with Mr. Rowe. Do you agree that the mere movement of retail prices, retail rates or prices is not the true measure of success for a competitive market, but it's really something much more qualitative such as the measures that I've laid out? Are there different measures that really are the proper benchmarks?

MR. ROWE: I would defer to someone like Professor Joskow for an elegant list, but I agree entirely with your formulation. If it's a particular price result, then all systems fail because none of these systems have the power to manage everything that's going on in life. We're just not that big and you shouldn't condemn competitive systems for rising prices of gas that are influenced by world geo-politics and economics any more than you can totally condemn another system for it. I concur entirely with your qualitative list.

CHAIRMAN KELLIHER: Dr. Joskow, what really are the proper measures of success?

DR. JOSKOW: I think you laid out an extremely comprehensive list. The only thing I would add is when one does look at prices, the proper comparison is not to what prices were in 1996 or 1994. The proper comparison is a counter-factual. What would prices have been if we had kept the old regime and I've actually done that for myself for my home and tried to run the counter-factual if we'd had the old regime. I think my rates would have been a lot higher under the old regime, given the price increases, given the cost overruns that some owners of new capacity have had. So I think those are the list of things we will looked at and I've looked at those lists to the extent that we can, given the data, all over the U.S. and also in foreign countries and I think there's pretty compelling evidence that you get a lot of those dimensions of efficiency improvements when you create the kinds of high-powered incentives that markets create.

CHAIRMAN KELLIHER: I'm going to try and get two or three quick questions in my time remaining.

First, there's re-regulation. Let's put aside the notion that competition is national policy in wholesale markets and let's say we want to go back to re-regulation. It's not entirely clear what that means to me, but if it means return to -- assuming there's a monopoly in generation, returning completely to vertical integration, how would you actually do that in New England? Vertical integration really doesn't exist much in New England any more by virtue of state action, not federal action. How could you put the genie back in the bottle in New England?

DR. JOSKOW: Since I'm from New England. I think you can't unless you're going to expropriate the generator's property.

(Laughter.)

CHAIRMAN KELLIHER: We have limits on our jurisdictions.

(Laughter.)

DR. JOSKOW: In the end, if a state wanted to buy back all its generation, it would have to pay market price. They'd have to put it in the rate base and you use regular utility accounting. I think the rates would be even higher than they are now.

CHAIRMAN KELLIHER: Let me ask one quick question to a number of you. I think Bill, Linda and I think Dr. Joskow all kind of suggested that the Commission should exercise its full authority under New York. I wasn't going to ask this question, but I thought your comments were interesting. Are you saying we should do that because it's preferable for efficiency purposes or is it necessary to prevent under discrimination preference?

And I've just run over my time. Is it necessary to promote efficiency? Is it preferable to promote efficient? Is it necessary to prevent undue discrimination preference? What goal would be advanced by doing that?

MS. STUNTZ: I'll take a crack at it. I believe it's necessary for efficiency and adequacy of transmission at this point. I'm just going to give you one example that finally pushed me over the edge on this, knowing how hard it is -- a real world example. A small reconducting project that could relief an identified for 10-year constraint in an organized market. I'm not talking about outside the market, an unorganized market. Well, the entity that could make the change is on the low side of the constraint. So actually it might increase the price of power in that state. So that state, because it still has 90 percent of its transmission revenue requirement in that state, it doesn't make that investment. That investment is not made and the regional benefit is not achieved. So I believe if, in fact, transmission rates -- you regulated them and there were pass-through items the way that they are with natural gas rates, regional planning would be effective. We would have more efficient transmission. We would get it build depending on renewables.

CHAIRMAN KELLIHER: Bill, I'll have to ask you to respond to that in writing. I've run over my time.

DR. JOSKOW: But I support that 100 percent. I just think that was a very articulate statement of what the issue and I want to support it 100 percent.

CHAIRMAN KELLIHER: Thank you.

Commissioner Kelly, seven minutes, please.

COMMISSIONER KELLY: I'd like to make a few introductory remarks before we start running the clock.

(Laughter.)

COMMISSIONER KELLY: If you'll bear with me and I appreciate the digital economy, but I think that being slaves to the digital economy is not the greatest. And so I appreciate the fact that you are willing to go beyond --

CHAIRMAN KELLIHER: It's more that our lunch is suppose to start at 1:15.

(Laughter.)

COMMISSIONER KELLY: I wanted to thank you all for your participation and the one thing that struck is that, although all of you were asked to comment on the past and how we got to where we are, all of you commented on the future. And most of you talked about the innovations that we've seen in the energy sector. I think probably now I'm moving into my question. You can start.

I think that the Commission has made progress in integration renewables and demand response into the grid recently, in the last year or two, in opening wholesale markets to them; providing a platform for participation of demand respond in electric markets and I believe that these efforts will bring benefits to consumers, not the least of which is lower costs and more reliable electric power. However, I think it's broader than that. There is significant interest across the country -- and many of you have touched on it -- in discussing these resources, not only as a way to lower consumer costs but also to mitigate pollution, to improve our energy independence and to provide jobs at home and develop the resources that we have here that we haven't developed. Many of which are in rural areas. And oftentimes, the places where the renewable resources are, are the places where the people aren't.

I'd be interested in your comments on how competition can work to foster these developments even to a greater extent and particularly where the organized markets are better to do that, whether organized regional transmission structures are better to do that and whether we can accomplish that without those structures.

DR. JOSKOW: I need to do my remarks very quickly because I know you have other questions.

Take New England, there are six states and New York. Each state has its own programs for renewable energy, different standards, different categories, but having an organized market, having the ISO in the center of this, managing it, keeping track of the electrons and who's producing them and who's contracting for them has made for a very smooth integration of six states that could have been a complete disaster. So you can generate wind in Maine and sell it to a buyer in Massachusetts, get the energy credits in Massachusetts and only sell it once also and two weeks later you can sell it to a buyer in Connecticut. It goes right through a standard transmission tower. It's a very attractive place to enter the market for renewable energy because it is an organized market and because these barriers have been eliminated and increased coordination with New York is making it possible for those wind generators in upstate New York increasingly to sell into states in New England. So I think it really helps to support many of these state programs that would be very difficult to realize if each state were trying to do it on its own in its own little area.

COMMISSIONER KELLY: You also mentioned demand response in your remarks.

DR. JOSKOW: Yes. The ISOs, PJM and New York and New England have made a renewed focus on increasing demand response to allow the markets to work more effectively during scarcity conditions, during high demand conditions when capacity is short. And I think that's very important for making these markets work and for providing incentives for investment and in the long run, perhaps, for eliminating these capacity payments and replacing them with scarcity pricing.

I only agreed with one that that John Anderson said, which is that there is asymmetry on the demand side and the supply side. If you look at some of the filings in the New England LICAP proceedings, there's a building big enough for them. There is a calculation on the margin. The marginal kilowatt for the marginal megawatt to meet the MPCC reliability criteria is about $250,000 a megawatt. If we don't pay any more than a thousand dollars a megawatt hour on the demand side and we need that symmetry between the two to encourage demand side and the supply side to compete and to integrate the demand side to be able to be dispatched along with energy in these markets and we're moving forward. I'm very pleased with the way we're moving forward.

MS. STUNTZ: You have pending before a petition for declaratory order from the CAL ISO, which think is very important and I put this in the comment file, but I think it's still open for comments. But to me, that shows the benefit of, in that case, the CAL ISO, stepping forward, I believe, with their stakeholders and saying in order to attach significant new wind resources we have to find a way to finance the up front costs because these are small and I think that shows to me the benefits of having an organized market to be able to face this problem, to deal with it in a coordinated fashion, which is very difficult if you're out in other parts of the country where you don't have that mechanism and whatever you choose to do I think it's going to set an important precedent. I personally think it makes a lot of sense and might help remove a very important market barrier.

DR. ANDERSON: I would agree that having a mandatory regional entity will bring about the integration of these things, especially if legislators tell the entity that this is what they have to do and I think that can happen. But that can happen under regulation or it can happen under the kind of thing we have under ISOs or IGOs, either one. We would rather see it done by market forces than we would by regulatory forces. There's no doubt. Our problem is that we just don't think that the ISOs and IGOs out there are producing things that customers want.

The one thing the chairman left out of long list of eight things or whatever it is, is customer satisfaction. And to me the thing that you all need to look at very carefully is what happening in the regional markets. Maryland, New Jersey, Connecticut, Massachusetts, Illinois -- these are places where there is tremendous customer dissatisfaction with what's out there and what they're going to do is come back and say -- they'll just give it up. They'll throw their hands up and say I don't want any more to do with this.

Now we can still have integration of this under regulation. There's no doubt about it. It's just is that the best for customers and I don't think it is.

COMMISSIONER KELLY: Glenn?

MR. ENGLISH: I would also point out that many of the same problems -- as I have tried to do in my testimony, the same problems that you have today that we've experienced in particular as far as electric cooperatives are concerned is getting competition and the reason we're having that difficulty again is the transmission system doesn't run out there. It isn't built there. It doesn't exist there. And if, in fact, you're going to take full advantage of incorporating renewables, you can't just have a regional thing where it kind of pops up wherever there happens to be a transmission system. You're going to have to build the transmission system to where you can generate those renewables and that, in many case, in most cases, is not where it exist today.

COMMISSIONER KELLY: Well, Glenn, Linda mentioned a proposal from California. It's from the ISO, but it's also supported by most of the stakeholders in California. That would for the first time ask us to establish a policy on transmission building and cost allocation specifically for reaching renewable resources. Do you think that we should consider looking at this and seeing whether there is merit in applying it to other parts of the country?

MR. ENGLISH: I think that what you've got to look at is, if, in fact, we're going to move into the future. We're going to deal with the climate change issues -- and renewables is going to play a big role in this -- what you've really got to look for is a new definition of "efficiency." And when you're talking about efficiency is if a system doesn't exist there, it's not efficient. You k now, it's not a question of what you're really made up with as far as technology -- you know, what kind of wire you use and everything else. So the real question that you've got here is not a case of, well, you go out and build your wind generation and they will come. It doesn't work that way. You've got to get the transmission to the areas where we have to develop a renewable industry and it has to be a national industry.

COMMISSIONER KELLY: Thank you.

MR. MASSEY: Commissioner, may I respond to that?

CHAIRMAN KELLIHER: Bill, I think in writing.

Who else? Anyone? John?

COMMISSIONER WELLINGHOFF: Mr. Chairman, does this mean I get eight minutes now?

CHAIRMAN KELLIHER: I guess so.

(Laughter.)

CHAIRMAN KELLIHER: Let's forgo our break.

COMMISSIONER WELLINGHOFF: No, I'll try --

COMMISSIONER KELLY: Well, if we're going to forgo a break, can Bill answer.

CHAIRMAN KELLIHER: No.

COMMISSIONER KELLY: Real quick.

(Laughter.)

COMMISSIONER KELLY: I want to talk about what happens in New Mexico. In New Mexico, the constitution requires us to have a legislative session 30 days and no more. So the venerable practice is at 10 minutes before midnight on the 30th day is to unplug all the clocks. So I think we should consider that.

CHAIRMAN KELLIHER: But it's not New Mexico.

(Laughter.)

CHAIRMAN KELLIHER: It more that we have a long day. I don't know how many more panelists we have to hear from and if we start running over, we're going to be here for quite a while. So let's turn to John.

COMMISSIONER WELLINGHOFF: Dr. Joskow, I wanted explore with you. Did you indicate that in New England you believe that there is not price symmetry between demand resources and supply resources. Is that what you said?

DR. JOSKOW: Yes. I think it's discussed in one of the papers I cited and it really comes from the MPCC reliability requirements, the long-term reserve requirements. If you back out and say what is the value of lost load that is consistent with this reliability requirement on the margin for the last megawatt, it's about 100 times the price we pay on the demand side. I have a paper on my CV, which explains that with capacity markets or with scarcity pricing there should be symmetry on both sides of the equation. And at prices that high, you're going to get at least some integrated demand response to replace some of that generation and you'll get some demand elasticity in the market, which will allow you to let the prices clear the market rather than having administrative rationing rules and I think that's something that's really worth investigation.

I also think it's worth investigating where all these reliability rules came from and whether they make economic sense or not. Are they too tight? Are they too loose? We've inherited all of these from the old regime without ever looking carefully at what their economic merit is and I think some of them, quite frankly, were introduced during the 1970s when there was excess capacity in the industry to justify the excess capacity and I think, especially with the Energy Policy Act of 2005, this Commission, along with NARUC -- whatever it's called now -- should look at these and see how market mechanisms like demand response can be factored into the reliability system in a way that has much lower costs.

COMMISSIONER WELLINGHOFF: I appreciate in your comments supporting robust demand site programs and demand response and I wanted to follow it up a little bit beyond the price signal issue. Do you see any other non-price barrier to things like demand response getting into the market, being more fully integrated into the market?

MR. ENGLISH: There are some attributes of -- especially for smaller customers of the network that make it difficult to implement some types of demand response, so priority rationing contracts can't be implemented for me because they can't control my house. But they can put a real-time meter in house or use my Internet connection with real-time pricing to allow me to use devices to control my water heater and my space heater and my air conditioner. And here we're at the interfacing state and federal regulation. I don't think it's any conflict here. I think it's a question of, at least in New England, of the ISO working with the states and providing the correct incentives to distribution companies and to consumers to put this equipment in. I need the Internet and the diffusion of the Internet creates tremendous opportunities for demand response down to the smallest household and I think we need to try to start to exploit those.

DR. ANDERSON: I'll just give you some specific examples in another -- not in New England.

COMMISSIONER WELLINGHOFF: Sure. You were my next question to you anyway, John. So go ahead.

DR. ANDERSON: I was going to say that there's a lot talk about demand response in some of the ISOs, but then there's a lot of restrictions put up. A six-hour interruption is kind of arbitrarily kind of thrown in for one of the things. Three-year forward auction sometimes come up where these are thrown out there. And so they say, yes, we're going to let them be symmetrically treated, but no, we're going to put up a lot of barriers to them and we can go into more details on them.

On the price idea, PGM itself admit at $650 million worth of savings on one day, but they only paid 5 to $6 million to the people that participated. To me, this is a gross example of lack of symmetry. Now I'm not saying that you should pay the customer $650 million, but there's a difference between $6 million.

COMMISSIONER WELLINGHOFF: There's a lot of money in there.

DR. ANDERSON: It's very close to Paul Joskow's 100 times, I think, on this.

COMMISSIONER WELLINGHOFF: There's a lot of money on this. It could go to the demand response providers to provide more robust demand response.

DR. ANDERSON: Yes, Commissioner.

COMMISSIONER WELLINGHOFF: Right.

In that regard, I appreciate your seven expectations and I think we all share in those expectations and hope that we can move them into fruition. How far do you see more robust demand response moving us towards those expectations if we can get more demand response into it?

DR. ANDERSON: I think we need all of the things we talked about. There's no doubt. But moving toward demand response would be a tremendous step forward. It would bring a lot of uncertainty into the markets. The generators would have a very, very difficult time then knowing what the price is going to be tomorrow when they're fabricating their bids. Their bids are not cost. They're not bidding their costs. They're bidding their bids and with the unknown of the demand response it's just going to create a situation that's going to bring down the price spikes tremendously and I think bring tremendous benefits for customers, which I think is something that's very attractive.

COMMISSIONER WELLINGHOFF: Thank you.

MR. ROWE: Commissioner Wellinghoff, could I just add to that?

COMMISSIONER WELLINGHOFF: Sure.

MR. ROWE: My company would support most measures to more adequately reflect the value of demand response. You can come to a company like ours. You can come to a company like Constellation and you can propose a load shape factor that reflects that and we would love to do business with you right now in the wholesale market because it has clear value to us. We're negotiating contracts as we speak and there are different contracts for different load shapes, but people can do that right now and they don't have to wait for the reform of the rules.

COMMISSIONER WELLINGHOFF: Do you have any objection to people doing that or going directly to the RTO?

MR. ROWE: No.

COMMISSIONER WELLINGHOFF: I don't have any further questions. I think I made it.

CHAIRMAN KELLIHER: Very impressive.

COMMISSIONER WELLINGHOFF: Mr. Chairman, thank you.

CHAIRMAN KELLIHER: You're very efficient with your time.

(Laughter.)

COMMISSIONER SPITZER: Stopping the clock can be perilously.

(Laughter.)

COMMISSIONER SPITZER: Commissioner Kelly brought up the New Mexico legislature, in Arizona there was a state senator who stopped the clock --

CHAIRMAN KELLIHER: We stopped the time change in

Arizona.

COMMISSIONER SPITZER: That's also true. But the state senator -- I removed that state senator in 1992.

(Laughter.)

COMMISSIONER SPITZER: There was a popular evulsion to the stopping of the clock, so it can be perilous and I will make one comment, raise two questions and then yield my time.

The comment is I have a very graphic memory of the investor relations issue in the old regime. My amateur stockbroker dad convinced my mom to take her surplus revenues from public school teaching, such as they were, and investment in LOCO in the 1970s. As my mom as complained to my dad for about 30 years as a consequence to that episode, so again, the old regime was not so necessarily wonderful from the shareholders perspective.

Question No. 1 to sound off -- the restructure arose really in the high-cost states and there's a term "what's in it for me?" We have a national grid. There needs to be some national consensus. What's in it for the low-cost states, No. 1? How could they be persuaded to sign on to this episode?

Secondly, Mr. English, Mr. Anderson, particularly, raised the point of bilateral contracts, which I've heard from consumer groups and was predominant in my jurisdiction in terms of what the consumers groups wanted in terms of mitigation of volatility. The end users really like long-term contracts and there's not a monolith in the non-RTO regions. There are some markets that arise based on long-term contracts. But again, there are again non-RTO markets where you don't have those transactions and the markets that Mr. Skelly needs for financing and hedging for winds are not available.

What can be done in both the organized markets, very specifically and Ms. Stuntz alluded to this and teased me somewhat. What can be done in both RTO and non-RTO regions with regard to long-term contracts. So the WIIFM for the low-costs states, long-term contracts, non-RTO, RTO.

DR. JOSKOW: I'd just like -- I'll answer the question, but first I want to make it clear I don't think we should pre-judge that 20-year contracts are the way this market should be organized. Oil companies billion dollar oil explorations perhaps ones with non contracts whatsoever, cruise ships cost $600 million, the longest contract is a week. I think the real problem with investment in the organized markets has been the instability in the market rules and the absence of either scarcity prices or some substitute for it.

Today, and I think there may be a misimpression here. Most of the energy traded in the New England ISO and the New York ISO is not traded in the daily spot market really. It's traded through financial contracts -- the week ahead, month ahead, year ahead, two-year ahead, three-year ahead. These markets are only balancing markets from a mandatory perspective and I think the best way of stimulating the kind of contractual regime, which reflects consumer preferences is to stabilize both the wholesale markets and those states that have chosen retail competition to move forward with it to stabilize the retail markets.

If you look at England, which has a mature what they call a liberalized market system, they're building power plants there without long-term contracts and they're building them because there are companies there that have significant retail supply portfolios that provide sort of a hedge that they can use to support investment in those facilities. And if they need a further hedge, they go to Morgan Stanley and they can work one out on a bilateral basis. So I think stability of market rules and in those states that have opted for retail competition, bring it to fruition is really the answer to the investment problem along to some of the fixes in the wholesale markets that we've discussed.

COMMISSIONER SPITZER: Ms. Stuntz?

MS. STUNTZ: I do have a slightly different view. I would certainly not recommend a wild swing back to all long-term contracts. What I believe would be ideal is a portfolio approach where you have some committing at volatility and I do think -- I'm not an expert on cruise ships and oil platforms, but these generation assets are typically 30-, 40-year lived assets. I think these other things are more depreciable and so what you see actually in the markets outside organized markets in the Northwest, for example, I'm aware there still are as a pretty vibrant bilateral market.

But inside the organized markets I think what seems to have occurred is because you can always get -- both suppliers said because I can always get whatever the marginal price is they don't have a great incentive to offer a long-term contract for generation resources at less than that price because they're always guaranteed that price. So buyers who seem to get those contracts aren't finding them and I think what would help -- I know one thing again that seems to be working in California is a plan that has been developed after a couple of false starts that put some of the risk of longer term contracts in a retail access state -- you could say socialize it, spreads it out even among the customers who may not procure power from that utility. Otherwise, there was a standoff. The utility as saying I am not going to sign long-term contracts when I don't know what my load is going to be. And those who wanted to sell to the utility said I can't build generation unless I have a long-term contract, which I can get financing.

So I think there has to be maybe look at what California has done. Mr. Anderson and others could talk to the experience of industrial trying to get long-term contracts to hedge the market and then Mr. English can talk about what's happening -- as I said in my comments, it looks like most of the generation that's being built in this country, if you look at the list that DOE has, for example, on coal plants anything other than sort of gas combined cycle plants there's a fair amount of involvement of municipals or co-ops who have the security of a market that they can then use to go forward with the investment. And so I think it needs exploration. I don't have any simple answers, but I think it needs to be explored as part of the work that know you're going to be doing with NARCU.

DR. ANDERSON: Just a couple of good things. First, you asked what's in it for low-cost states? To me, nothing is in for low-cost states if you take the model that we have in the Northeast -- PGM and New York and try to put into low cost. What we do think would work, though, is real competition. We can't even get smart meters put in. Real competition is going bring technological innovation like we haven't seen. It reminds me of the old days of telephones. You could have any telephone you wanted as long as it was black, it had a rotary dial and it sat on a horizonal surface. Look at what you've got now. I mean it's incredible what has come about because of the technological innovation. More on that later, though.

You asked about bilaterals. To me, we've got to find some way for the generators and load, but right now the generators are very happy to be in the spot market. That's just simply what they are. They're very happy to be there. They have no economic motivation to do any thing other than take that price, so that's what they're offering. Off Jam, at least in the U.K. -- I think it's still on their website -- said 98 percent of their transactions are in bilateral contracts now. So I have to look and see what it is. In our view, the risk is still on the consumers today. It hasn't been transferred to anything like that and so the risk kind of thing doesn't go. But I think we need to find a way of getting both load and generation unhappy with the spot market and do it in a just and reasonable way.

Mr. Chairman, I understand it's got to be done legally, of course, but find some way for that to happen.

(Laughter.)

DR. ANDERSON: And then they'll go out and negotiate bilateral contracts that make sense to both parties.

DR. JOSKOW: I just think that a lot of that is not factually correct and maybe I'll just respond to that in written comments.

MR. ROWE: Could I just comment?

COMMISSIONER SPITZER: Yes.

MR. ROWE: We recently finished in Illinois what was a variation on the BGS auction. There were 16 winners. Many of those winners bought the power that they bid from a whole variety of suppliers in bilateral contracts. We had to buy cycling and peaking capacity from others. Some people bought nuclear from us. Generators are not simply selling into spot market. They're making contracts all the time that underlie those transactions you see in the spot market. We are prepared to make contracts with people who are prepared to pay what we believe to be a competitive price for those contracts. What is going on, however, is that we all look at the long-run marginal costs of new facilities. nuclear coal and they're going up. And people want to some magical contract that doesn't reflect the long-run marginal costs of the product and no one is going to do that no matter how much you're with the structure.

CHAIRMAN KELLIHER: Thank you.

Mr. Moeller.

COMMISSIONER MOELLER: Thank you, Mr. Chairman.

I'd like to start off with Congressman Sharpe and I'm so glad you brought up the 1990 Clean Air Act because --

also like Congressman English's thought on this. But it seems to me as society we make decisions through our legislators to make priorities. And it strikes me that in the 1990 Clean Air Act we basically made a decision as a society that natural gas would be the generation fuel of choice going forward. What are your thoughts on that?

MR. SHARPE: I don't think it was quite as self-conscious as that, but clearly the availability of gas influence the view that what you could with the 1990 Clean Air Act, no doubt about it. But obviously, I think the natural gas was not just appealing because of its clean air qualities. It was also appealing because of the capital investment requirements and because of the past experience of people of being burned by bigger investments, which pushed the investors in that direction. So I think a number of factors pushed in that direction.

But of course, you're now confronting the grand daddy of all environmental issues is climate change, which is going to come crashing down on this industry.

COMMISSIONER MOELLER: And potentially increase our dependence on natural gas.

MR. SHARPE: If the natural gas is available, it won't increase. Dependence on any gas that isn't available, but this Commission, I think rightfully so has been trying to cite LNG terminals as one potential. There is at least a claim that there's plenty of gas available internationally. It hasn't all be drawn out of the ground yet, but that infrastructure is growing rapidly to be able to go around.

COMMISSIONER MOELLER: Congressman English?

MR. ENGLISH: I would also go back a little bit further to the Natural Gas Policy Act of the late 1970. If you recall, we decided in the 1970s we were short on natural gas. Then we decided we had plenty of natural gas. Now we're deciding we're short on natural gas. We had to switch from natural gas to coal because we had plenty of coal. Now we decide we can't use coal. So that's just kind of the way this thing goes. The pendulum swings back and forth. And Mr. Spitzer, I'd go back to this short-term/long-term thing. No wonder you got to get something long term because the short term isn't going to last. Whatever it is you can figure it's going to be out of favor probably in 5 or 10 years and that's kind of the way thing goes.

I would agree with you, Mr. Moeller, with regard to the public policy because that's what a lot of this stuff comes down to is what the public policy is at this time. The whole matter of this question where we're going to have competition. As I said, that was about a 20-year window here, but we were all infatuated with competition and that's how we passed the law. Now it's not so much fun. I rode on the airlines. If any of you have ridden on the airlines --

Bill, did you vote for the airline deregulation bill?

MR. SHARPE: I'm sure I did.

(Laughter.)

MR. SHARPE: I voted for all of it.

MR. ENGLISH: I just want to point out, you know, you pay for your sins and I've paid for it just about every week when I get on those airlines.

But the point that I'm making is this, very quick, this stuff changes back and forth. It is a public policy issue and certainly climate changes, as Phil said, is going to be the grand daddy of it all. And that's going to have to drive a lot of it. That's the reason I think it is very important from the standpoint of this Commission that we get down to this question of what is the new efficiency. The efficiency is that the system, the transmission system, in particular, has to operate efficient. And part of the difficulty that we've had with regard to competition not living up to what we saw as the promise is the existing system. It wasn't built to do what we're asking it to do. We all realize that, but we haven't been willing to take the steps, either the Congress giving the authority to FERC or maybe the commissioners to really make sure that that happens.

If we're going to incorporate renewables, if we're going to deal with climate change, we're going to have to take some action that's far more aggressive than what we've had up-to-date and that means that Congress will most likely will lead the way.

COMMISSIONER MOELLER: I remind you my ranch is on co-op lines, too.

MR. SHARPE: Could I just comment quickly because we've had a lot of experience with trying to regulate lots of markets -- oil, gas, and what not. And if there's anything that's true, it's neither the markets nor the government nor academics have been able to predict where the prices are going to be, have been able to predict the pace of technology and the wisdom would suggest to us that we'd want to keep our system of regulation as flexible as possible to maximum the possibility for innovators, for people who think out of the box and to allow for adjustments. And so every system that tries to tie us down in very specific ways almost always backfires and I think it's a lesson for why you want the competition in the wholesale market.

DR. JOSKOW: To reinforce that in the case of the 1990 Clean Air Act, the Cap and Trade System for SO2 have adapted very, very well to the dramatic changes in natural gas prices. And we've studied it over the years -- my group at MIT -- and actually relatively little of the savings now are coming from switching to natural gas. They're coming from low-sulfur coal, from scrubbers, from turning scrubbers on and off, depending on the prices and ultimately that you come from the demand side as well if you get these permit prices properly into prices in the wholesale market. So I just want to reinforce what Congressman Sharpe indicated. We've got to have a system that's nimble and can respond to changing contingencies because that's the real world.

COMMISSIONER MOELLER: Dr. Anderson, it seems to me you've got a few issues amongst your members. You want to get self-generation access to the grid. You want reliability, but ultimately it comes down to the price of gas. And if that if there $3 gas today, you might not be quite as upset as you are. Quick thoughts on that.

DR. ANDERSON: Your point is absolutely true that the price of natural gas has affected the price of electricity. There's no doubt about it. But I think it's also true that at least most of my members, if not all of them, operate very, very actively in the natural gas market. They buy tremendous amounts of natural gas. They know very good and well what natural gas prices have done and what they're doing to electricity prices.

They also know that under the old regulatory regime, if a utility had 20 percent natural gas and 80 percent other things, and the price of natural gas would go up, the price goes up on the 20 percent part but it doesn't go up on the others. Now other things can affect the other 80 percent, but -- and we also know that in the kinds of auctions that we have today where the highest priced bid that clears the market is paid to everybody and that it happens to be natural gas on the margin in an awful lot of hours, at least in the scarcity hours, that you're getting 100 percent of the prices then set on natural gas.

COMMISSIONER MOELLER: But that's partly because of the society. We've made natural gas plants easier to cite than anything else.

DR. ANDERSON: That's very true. I certainly agree with you and I think there's tremendous disadvantage of it. Glenn just talked about we go back and forth between gas and coal and all these kinds of things. That's very true.

MR. MASSEY: May I respond on that, please?

COMMISSIONER MOELLER: Quickly, please.

MR. MASSEY: It seems to be fairly explicit criticism of the single clearing price model, but there's a lot of economist work on that I'm sure Dr. Joskow can talk about at length and a lot of work that shows that if you go a different model like an As-Bid model you don't save any money at all because there's a bidding discipline built into the single clearing price that is not in the As-Bid market. So I would just throw that out there.

DR. ANDERSON: I just must say that I agree that going to As-Bid is not going to solve the problem at all. There's exactly no doubt about that sort of thing. It's just that if 98 percent of the transactions were in bilateral contracts and 2 percent were in the spot market, we wouldn't care much about what the prices are in the spot market.

COMMISSIONER MOELLER: My last question.

Linda, I first met you when you were working for Admiral Watkins in '89 National Energy Plan and I remember back then those days of Bonneville costs projections going. It wasn't a question of whether they're going up. It was how steep the curve was. A funny thing happened in the mid-'90s when they had to face some competition on the whole West Coast market, but I guess I'd like your few good old days thoughts on that.

MS. STUNTZ: Thank you.

I thought Mr. Sharpe was eloquent in terms of how often we are wrong on what we think are going to happen in energy markets and energy technology and I agree that the system needs to be flexible. But to the extent, you know, anything seems certain it seems to me that the price of natural gas is going to be under continuing pressure whether because of the geologic reality I talked about, because of climate legislation and so the role of natural gas in the electric sector is something we have to really think about and the role of natural gas in setting market price. And as I said in my statement, I wouldn't dare to every disagree with what the economists, in terms of what the efficient outlook is, but I do sense that there is -- and you've seen some of the state reports yourself. There is concern why should natural gas at the margins set the price of existing coal and nuclear and how does that interact with society's interests in a less carbon-intensive generation mix. It's going to be complicated.

DR. JOSKOW: This is deja vu all over again. But the simple answer is that's how you pay for the capital cost of new capital-intensive technologies, including wind which had zero fuel cost. Do you think we'd get much wind if we charged zero for the wind? I don't think so.

CHAIRMAN KELLIHER: I want to thank the panelists for their participation today. You gave us a lot of good ideas and some provocative ones. I think we will take a very short break, then resume at 11:20 a.m. Thank you.

(Recess.)

CHAIRMAN KELLIHER: We're going to resume. I'd like to call the second panel up. Please end your conversations or take them into the hallway.

I know some of you and you have pending matters before the Commission, so we're going to keep a list.

(Laughter.)

CHAIRMAN KELLIHER: Let me recognize our first speaker and that's the Honorable Erin O'Connell-Diaz, a commissioner with the Illinois Commerce Commission. Thank you.

MS. O'CONNELL-DIAZ: Good morning. Thank you, Chairman Kelliher, other commissioners and the assorted guests that are here today. I would be remiss if I did not suggest that --

CHAIRMAN KELLIHER: Excuse me. Why don't you hold for a moment? Can we close the door in the back? Thank you.

Why don't we reset the clock? Thank you.

MS. O'CONNELL-DIAZ: I'm not going to say good morning again.

(Laughter.)

MS. O'CONNELL-DIAZ: I would be remiss to suggest that the comments that I make today are anybody's but mine and they are not the comments or thoughts of my fellow commissioners nor the Illinois Commerce Commission in general.

I'm very honored to be here today and would like to thank you as well as NARUC for the opportunity to discuss with you the status of electric restructuring in Illinois. As you may know, it's been quite a ride and we're still rumbling down the road. I would like to share with you a few highlights of our 10-year journey from an old cost-of-service methodology of recovery to one based on competitive prices.

As you're probably aware, our state enacted a Restructuring Act in 1997. The Restructuring Act served as a road map for driving the Illinois electric industry to a competitive market structure. It did so by providing electric utilities the opportunity to restructure their businesses and become more productive and reliable while mandating a reduction rates for residential consumers, a rate freeze for all customers and allowing customers the opportunity to achieve savings by shopping.

As a result of these Restructuring Act's directive, there has been a dramatic change and very positive changes. From these actions, there has been a savings of upwards of $6 billion a year that is the pockets of Illinois consumers based on the savings that have occurred due the rate freezes and the reductions.

Additionally, consumers have selected alternative suppliers. This past January, I think we were looking at figures in the ConEd service territory of 61 to 62 percent of shopping that was occurring. Amerind also has those type of figures. So obviously, we're doing something right. Additionally, there's been over 9500 megawatts of new generation has been built in our state and that has been built by investor investment in our state as opposed to the old model, which would have had it on the backs of the ratepayers. So these are positive, positive features of this Restructuring Act.

Back in 2004, knowing that we were going to have to grapple with the issues of the transitional period, the commission initiate what we call the post-206 Initiative and this was a workshop process that brought all the stakeholders together. I think we had 250 various stakeholders in our process. In that process, all discussions were had with regard to procurement methodologies, rate structures, competitive issues, low income issues. We looked at every item that we thought was an important item that needed to be in place when we got to this point in January when the rate caps were going to come off.

The undertaking was well worth the time and effort. Much that was achieved during those workshops were things that would have been litigated in courtrooms and battled out and we resolved some of the issues there in those workshops. Additionally, it was an educational opportunity, I think, for many of us who really didn't understand all of what this restructuring was all about. And restructuring, I think, is an important word as opposed to deregulation. I think that has been a marked comment this morning that I've heard. The commissions are not going away. We are still there. We are mandated by law to still be there and we will continue to be there.

Also, in our Restructuring Act, our act has not changed since its inception in 1997. It is our job at the commission to implement that legislation. We are not legislators. We are there to implement the laws as our state passes them and that is what we have been doing for this 10 years. During that process we were very pleased to have the participation of FERC. I know when I first came on as a commissioner I kind of thought FERC was some place out in Washington and they never really came to visit us out in the Midwest, but I was very, very surprised and felt very lucky that the Commission would focus on our state and participate in our post-206 efforts. And I'm very, very glad to see that three years down the road that I'm sitting here talking with you. That I've had an opportunity to speak with you at various NARUC events. That that connectivity that needs to occur between the different regulatory bodies, given the fact that we all have different roles, but we all there for one purpose and that is to come up with appropriate and good policies for the consumers in our states as well as our nation.

This past year the commission has been quite busy going back to the procurement orders that the commission entered with regard to the auction process that we used that allowed our Commonwealth Edison and Amerind to procure their electricity through a dutch auction model. I would suggest that it was very important in our orders and we took great pause to point to the FERC orders that were entered December of 2005 with regard to the affiliate sales. That was one of the big issues in the case that there was going to be buckram dealing and things of that nature. And the reinforcement of the Edgar and the Allegheny guidelines that were evident in that order gave great comfort to the commission itself and as we were asked by legislators and we are continued to still be asked by legislators about who's minding the store and who's making sure that things are done in an appropriate fashion? So we were very, very pleased to rely on that and we would continue to suggest that those are important features that we as state commissions need to know that we can rely on you for that.

This past September, as I think Mr. Rowe alluded to, we had the Illinois auction. It was actually two auctions in the same day. In my handout, you can see the various points and time with regard to the prices that we've been having in our state, pre-restructuring, during the restructuring time and as well as the input form those auction results. In the ComEd service territory, we saw a rate increase of 22 percent. If you really look at it for inflation adjustment, it's 3 percent below the 1997 rate. We were very pleased with that result.

The bottom line is, is that electricity costs more and it's costing more every day as we go along. So our job is to find the methodology that will deliver the lowest price and a reliable service to our consumers. We were pleased that the auction was run in accordance with our order.

MS. PAUL: One minute.

MS. O'CONNELL-DIAZ: Additionally, the process was transparent and we also have come up with a menu of programs to assist our consumers with the higher prices. The commission approved the rate mitigation proposals by our two main utilities with some modifications. Additionally, we have the Real-Time Pricing Program that was started pursuant to legislation in our state and we're very, very pleased to have that for customers to take advantage of. Renewable energy portfolio standards -- we're hopeful that our companies will come and file those with use.

Retail competition in Illinois is an evolving story. We believe it is a successful story. Just this past week we had the -- Wrigley Field is now going to be served by Constellation Energy, so maybe this will help them win the World Series.

(Laughter.)

MS. O'CONNELL-DIAZ: But we would have never seen something like that before during the old regime. Our message to you and recommendations that FERC might be able to assist us with is the need for data and information that we can rely on. In many states we have an obligation to ensure just and reasonable rates just as you do and that those are at least cost. Certainly, in Illinois, that is our mandate.

I know that FERC has initiated dedication of resources to your Office of Market Monitoring and we really appreciate that. However, with regard to the issue of the data information, we are not able to sign those disclosure agreements. So we would encourage you to take a look at that and see if there is another way to work that around because that is important for us as state regulators to be able to get that information so our staff can look at it and make sure that the representations that we are making to our public is verifiable.

Additionally, we've got a seams issue in Illinois, which I'm sure you're aware of. Illinois, like many other states is cut in half and we have the Midwest ISO and PJM. These seams negatively impact our markets. You can see that in some of the clearing prices from the auction. So we would encourage FERC to coordinate with state regulators to improve the structural competition in those wholesale markets.

And on the last note, with regard to transmission, it costs a lot of money and we want to ensure that we're getting the fair share for what we are going to be asked to pay for that. So that is something that we would request that you remain mindful of.

I think that we, as regulators, must work together with our companies, with our stakeholders to ensure that customers are getting correct and accurate information. There's a lot of misinformation out there. There seems to be a lot of misinformation in my state for about the last two years. But I think that is something that is a disservice to the public. It doesn't give them the true story and I think that that is just a fair thing that we can ask for.

I would echo Commissioner Stuntz's comments at NARUC last week where he suggested that the authority of FERC versus state commissions, while different in the end, we have the same constituents, the consumers. So it is that common interest that should guide our next step. There is much work to do to continue our drive to a fully competitive market. Short-term fixes are not the answer. We all need to be in it for the long haul and I would thank you very much for letting me participate and I look forward to any questions you might have.

CHAIRMAN KELLIHER: Thank you, Commissioner.

I'd like to now recognize the Honorable Elizabeth A. Betsy Moeller, former chair of FERC, and currently the Executive Vice President of Exelon Corporation.

MS. MOELLER: Mr. Chairman and Commissioners, it's a pleasure to be before the Commission today.

As you can imagine, the subject you are addressing is near and dear to my heart. I believe that this Commission should be proud of the progress it has made on a bipartisan basis in developing competitive wholesale markets. Regional transmission organizations with organized markets serve two-thirds of our nation's populations. Their benefits, in my opinion, are well documented. We're certainly aware of the criticisms of competition in organized markets. But I would point out that those who criticized them have not offered any solutions. They simply whine.

In the brief time I have available, I would like to focus on four elements of organized markets that we think are essential to their success. And then, at the Chairman's request, I will summarize some things we believe the Commission should do to enhance their success. I'd also like to call your attention to a little Myths and Facts document that was included as an attachment to the testimony that John Rowe and I submitted that hopefully addresses some of the myths that I'm afraid are becoming urban legends and with facts that would refute them.

The four elements of organized markets, these critical elements would include a set of requirements to address reliability, adherence to the NERC rules, mandatory capacity requirements for load-serving entities and the obligation of all capacity resources to schedule or offer their full available output, no withholding.

Second, we need transparent and liquid markets for electricity. The Bid-Base security constrained economic commitment and dispatch -- those words just roll of the tongue -- in which all similarly situated generators bid market prices and receive market clearing price for their location known as locational marginal pricing. It's critical.

Central markets also need to be administered by an independent entity, including a market monitor to mitigate prices if a particular segment of the market is not competitive, enforce reliance on market-based investments -- it was discussed at some length on the first panel in -- in generation sources, not ratepayer funded, long-term commitments planned by policy-makers, regulators or utilities. We do not believe in central planning.

Any rule that would weaken or eliminate any of these four central elements would be a huge mistake. Anything less than a full commission commitment to maintaining single clearing price market rules would cause generation developers to invest their money elsewhere rather than risk an uncertain regulatory environment or the specter that Paul Joskow recounted this morning where you would have the government having to take back power plants.

Let me comment on some recommendations for improving organized markets. All of the organized markets are built upon the L&P single clearing price model, whether it's called L&P, Texas Nodal or the California Market Redesign and Technology Update. I believe it is fair to characterize L&P as a best practice for organized markets, but we should not stand pat. Our testimony includes some "Do's" and "Don'ts" for changes this Commission should consider to improve RTOs and organized markets.

With apologies to the soft drink company, we urge you to do the Do's and don't do the "Don't"s. My son is a Mountain Dew drinker.

(Laughter.)

MS. MOELLER: First, we need to facilitate market-based new generation in our RTOs. We need to make sure that prices in organized markets reflect the true value of the energy, particularly during periods of scarcity. FERC has endorse scarcity pricing. It is honored frequently in the breach in RTOs and I think this is a very important thing to address.

We also need to implement long-term financial transmission rights. The Commission is well on the way to doing that and I congratulate you. We also need to implement forward capacity markets such as PJMs, RPMs. I'm mindful of the fact that there are cases pending on rehearing. I'm addressing it at open session. There's no ex parte rule here, but it is an issue at play. But it is important.

Second, we need to direct RTOs to enhance demand response programs and to integrate them better with energy markets and scarcity pricing. To foster more demand response, RTOs need to better integrate demand response with energy markets and scarcity pricing. They need to remove barriers that keep qualified customers from participating in demand response programs, such as allowing aggregation of customer accounts and standardizing enrollment requirements to reduce costs. And they need to provide education training and dedicated customer support to support and encourage customers to participate in the demand response programs.

The FERC staff has also issued a paper on ways to help demand response and we commend that report to you. We think it has lots of solid ideas in it. We also need to adopt measures to resolve seams issues, requiring a common methodology for ATC and TTC, which was included in Order 890. We commend you for that and we're very pleased. We also think that we need to direct RTOs to better address day-ahead coordination based upon the results of the day-ahead transmission security analysis. Geeky stuff. It matters in the trenches. They need to work on it.

And finally, in our "Do's," we would direct RTOs to develop and implement best practices. The RTOs have a council. As the RTOs mature and regional differences are recognized, RTOs and their respective stakeholders really need to standardize some best practices across all RTOs. Some things work better in California. Some things work better in New England. Some things work better in PJM and you should call upon them, in our estimation, to identify the best practices and to implement them. Cost control measures should be standardized, too.

In the "Don'ts" category, I would say do not credit allegations that competition has caused electricity price increases. The real culprit is the cost of fuel. An appendix included in our prepared testimony shows sort of the march of increases in both markets with and without organized markets and regions with and without organized markets and you can see that it directly correlates with the cost of natural gas.

MS. PAUL: One minute.

MS. MOELLER: The Commission should not fall prey to this notion that RTOs are causing price increases. I would also suggest they should not replace clearing price energy markets with Pay-As-Bid or Vintage pricing. I was delighted when an earlier panelist also, who I expected to call for Pay-As-Bid disavowed that notion. I would also say you should not abandon RTOs and FERC's strong role in policing discriminatory practice.

Last and far from least, don't abandon RTOs. We strongly believe that development of regional transmission organizations with organized markets has shown demonstrable benefits as enumerated in even more detail in the prepared remarks. The Commission should seek to build upon the considerable successes of today's RTOs. Improve them. Don't abandon them. Doing so will enhance reliability, reduce customers costs, encourage generation investment, particularly in the non-traditional resources and continue to provide the resources we need for technology development to secure America's energy future. Thank you.

CHAIRMAN KELLIHER: Thank you very much.

I'd like to now recognize Gordon van Welie, the president and CEO of ISO New England.

MR. van WELIE: Good morning. Thank you very much for allowing me to contribute to this very important discussion.

Competition was implemented to provide a sound framework, to reduce costs, promote private investment in wholesale electric resources and better manage consumption to achieve the state of public policy goals reliably and reasonably priced electricity for consumers. ISOs and RTOs are well suited to guide this change with independence and transparency.

While there is strong evidence markets have met the intended policy objectives, assessments of the efficacy vary widely singly focused on the recent increases in electricity prices. But those who blame competitive markets for high prices misunderstand their function and the real drivers of price increases. Competitive wholesales markets are means to an end, not an end to themselves. Markets are essentially barometers measuring the relative strengths, weaknesses of the electricity system and providing an efficient way to value the alternatives available to consumers and policy makers.

Rising electricity prices are not the results of markets, but are the results of price increases and inputs such as the fuels needed to produce electricity. These price signals tell developers to invest. They also help direct consumers to use more or less electricity and ultimately prompt the development of solutions to improve the efficiency, the competitiveness and the reliability of the system.

With this in mind, competitive markets should be seen as a catalyst for achieving important national and regional policy objectives to the benefit of consumers. There is mounting evidence demonstrating the value of organized markets. The qualitative benefits of RTOs and ITOs speak for themselves, namely, fair and independent markets, guaranteed open access, improved power system planning, greater grid reliability and superior system coordination and management.

The quantitative benefits are equally compelling. Studies evaluating the results of competition fostered by organized electricity markets demonstrate substantial efficiency gains at the wholesale level and considerable progress with respect to investment in needed infrastructure. To illustrate, I will use a few examples from New England. Despite concern about rising retail electricity bills, when you factor out the increases in natural gas and oil prices, which together fuel more than 60 percent of supply in New England, wholesale electricity prices have actually dropped since 2000. This reduction results from competitive market forces which have driven the investment in more than 10,000 megawatts of new supply and it has improved generator availability from 81 percent to 89 percent since the beginning of markets.

Since private firms and not public utilities have made this new investment, consumers have been shielded from investment risks they've been exposed to under a traditional cost-of-service system. This consumer protection was a major objective of restructuring New England where billions of dollars of stranded costs that accumulated from poor investment decisions and you heard some more detail on that from Paul Joskow and John Rowe in the earlier panel.

A comprehensive regional planning process and stable cost recovery mechanism has improved the investment climate for transmission. After decades of delivery , five bulk transmission projects valued at more than $2 billion are in varying stages of construction and a six, multi-state project is being planned. In addition, we're investigating stronger ties with eastern Canada in order to try and expand the region.

For overall capacity needs, the region's planned auction base for capacity markets in 2008 will ensure resource adequacy by purchasing the resources needed to serve during demand. Early indicators suggest investors are confident in our marketplace with over 10,000 megawatts of new generating resources indicating interest, particularly, in our highest demand centers of Connecticut and Massachusetts.

Wholesale market improvements have also boosted demand response participation. We now have almost 1000 megawatts of demand response assets in New England, a relatively small region, which provide the dual benefits of lowering prices and ensuring reliable operations. I think it's unlikely we would achieve this level of participation in the absence of competitive wholesale markets.

Policy Act of 2005 and the Regional Greenhouse Gas Initiative or REG I.

While electricity market can help further REG I's environmental policy objectives, REG I can likewise help the electricity markets achieve their policy objectives. The REG I compact is designed to stabilize and ultimately reduce carbon dioxide emissions for our Cap and Trade system. If the proceeds of the proposed Cap and Trade auction are used to develop clean resources such as energy-efficiency resources, demand response and alternative fuels, then REG I will help diversify the region's fuel supply as well as help meet New England's projected capacity needs.

We believe there is a need to consider the potential convergence of REG I, the regional renewable portfolio standards and the wholesale markets. This coordinated development is the next stage in the evolution of wholesale markets in the region. New England has taken an important step towards the full integration of demand response and energy efficiency into the wholesale markets with a plan for capacity market.

We are not naive about the difficulties of treating demand response and energy efficiency as the equivalent of supply side resources. It has never been tried before on this scale and there are many complexities and risks involved to make work, but it is an untapped resource. Given the limited resource alternatives available to the New England region and the reluctance to allow the citing of non-gas resources, it's essential that some demand side resources be pursued for a variety of mechanism, including the competitive market.

Regional policy makers often ask me what can be done to get the price of electricity in New England more in line with the national average? The answer is to control peak demand growth and site resources that uses fuel other than gas or oil. Both of these solutions are easier said than done. Nevertheless, I believe markets are the most powerful tool we have available today for making problems visible and ultimately addressing them.

Nebulism is a powerful force to overcome. Local politics can make it impossible for state authorities to make decisions. For example, natural gas power plants are typically the easiest to cite because of low emissions, but New England has become over-reliant on it. This leaves the region with a choice to either accept alternative fuels like coal or nuclear or cite LNG tanks and natural gas pipelines, but neither option has been embraced.

Controlling costs becomes even more difficult because of the current gap between the wholesale and retail markets. If we hope to harness the potential of consumer conservation to lower costs and protect reliability, it is essential wholesale market signals reach retail customers. The structure or lack thereof currently in place between the two markets generally precludes this.

Although there is a concern on the part of many about exposing retail customers to price volatility, consumers are capable of adjusting. Education about the benefits of this change will be critical to its success.

MS. PAUL: One minute.

MR. van WELIE: Today's forum underscores the importance of having broad expertise within the commission to appreciate the interplay of all the issues before and in particular in emerging areas such as the integration of demand response, renewable resources and the impact of constraints on carbon emissions.

To educate industry representatives and government stakeholders on the implications of different resource situations in the region, ISO New England has initiated a stakeholder process called "Scenario Analysis" to examine the reliability, economic and environmental performance of a range of long-term resource alternatives for the region. The goal is to provide policy makers and consumers with the information they need to make choices about the future power system.

In conclusion, I urge FERC and conference participants to think of competitive markets as a tool for meeting some of the most difficult energy policy objectives facing the industry. Evidence suggest that organized markets are working and should be the appropriate path forward to achieve the goals of reliability, energy efficiency, demand response and the integration of renewable resources in the most efficient manner possible.

I challenge others to explain alternative mechanisms that would be as effective or efficient in reaching these goals. Thank you.

CHAIRMAN KELLIHER: Thank you very much.

I'd like to recognize Roy Thilly, the president and chief executive office of Wisconsin Public Power. Welcome.

MR. THILLY: Thank you and thank you for the opportunity to be here today.

The topic is strengthening organized markets. I approach that from a load-serving entity perspective relatively small with an obligation to serve, providing an essential service and our objective is to have affordable electricity for our customers over the long term and to keep our industries competitive through a diverse portfolio of resource. So the question is how the market enables us to do that or creates obstacles to achieving that goal. We participate in the MISO. We are also in PJM to an extent. MISO participation is primary defensive to protect ourselves from being hurt. It is a mixed bag. There are some positive. I believe the system is more reliable operated by a single operator that sees the whole system.

I think that the response to outage of lines is much more quick and causes much less problems for us in rearranging supply. There is greater transparency in short-term prices, pressure on availability factors as has been mentioned and the potential for lower reserve requirements to the extent that transmission becomes more robust. But there are also significant problems. I don't think that the market is getting new transmission or baseload generation built, as I'll get into.

Long-term contracts are very hard to get and dry up. There is a significant problem in creating stakeholders with an interest in congestion that can block or delay solving a number of these problems, which I think is an unintended consequence of the market. Frankly, Day One ISO with a balancing market, I think, would achieve 95 percent of the benefits at substantially less cost. But I do think we need to step back and this commission should step back and assess the results. You did not drive the creation of these markets and you've indicated a willingness to take hard look at what's gone before and we need to do that. We need a credible assessment of whether there are net benefits for end users through these markets and a bunch of dueling studies hired to come up with a particular result.

There are clear winners. I mean if you own a nuclear power plant, you've recovered all your strained cost from your customers in the past and you're getting a gas price 50 percent of the hours of the year. This is great. But that doesn't tell me whether customers are benefitting. Also, traders and FTRs maybe making a lot of money and they're pulling it out of the market, but what does that translate for the end user customer?

APPA has done a number of studies recently critique some of the analysis and the hype that's out there. They raise serious questions and I think you really ought to take a hard look at them. But I think this commission should step back. You have the resources and the expertise to really try to delve into the issue of do customers benefit or not. And if they're not, how can we make changes so that they do.

I notice that the questions for the third panel relate very much to my own system in terms of access to new resources, planning, et cetera. And I think the reasons there's a problem -- the question for this panel assume implicitly deregulation at the retail level and that's not true for many of us. The MISO is at least half unregulated states where there is an obligation to serve, where there is ratebase recovery for generation. And talking about scarcity pricing as a way to compensate for building new generation that's in ratebase and going to be recovered through ratebase makes absolutely no sense and one of the reasons we have so much controversy in the MISO area is because of the dichotomy between the regulated and the unregulated states and trying the impossible task of having the same rules apply in both areas. So I would ask you really to look hard at the facts on the ground with respect to that difference.

In terms of what you can do to help improve organized markets for us as load-serving entities, one is in governance. There's a tension between independence and accountability and I vote for more accountability to those who pay the bills. I think a hybrid board with a minority of people who are actually in the business, on the ground, paying the bills would make a big difference. I have seen that within ATC, which has a hybrid board and it is often the utility folks that ask the hard questions of management and I think more open decisionmaking would be helpful.

Second, you have gone a long way and we want to thank you for moving on long-term rights as required by the Energy Policy Act. Long-term rights for new resources are absolutely essential for us to develop the portfolio I was talking about and to plan and build new generation for long-term cost stability. but there's another step. You need to require the RTOs to plan the grid to meet the simultaneous feasibility test for our existing resources and our new baseload resources because those rights aren't going to be worth much if there in risk of substantial proration in the future because the system hasn't been built to meet those needs. So that's absolutely key.

The other thing I would urge is to move forward as you have been pressing for a robust transmission system to underpin these markets. Having a strong transmission system solves many, many problems -- lessens volatility, lessens opportunities for market manipulation, makes market monitoring much easier and I'm not sure whether that's working or not, makes it much easier to plan new resources and gets away from all the complexity that has to be developed because of congestion. So we really need to get that system built and to do it we should get away from this attempted distinction between economic facilities and reliability facilities. All transmission provides a reliability benefit over the long-term.

Second, we need to get away from the concept that every transmission project has to compete against efficiency or generation. Efficiency and conservation are extremely important. We should be doing the maximum we can, but we need a robust transmission system for these markets to work.

MS. PAUL: One minute.

MR. THILLY: The last thing is to get a regional rate into place that shares the cost of recovery amongst all the users over the long term. When we talk about facilities getting built, it really is an LMP pricing that's driving it with constant felt because we separated our transmission from generation and ATC. Cap X is moving forward because we had state laws that required cost recovery, made it much easier and we had the inclusive planning process. Power plants are not being built by LMP signals. Wind has to be built where there's wind. LMP tells you to build it at the load. Coal as to be built where you can site it, where there's an opportunity for carbon secession, where there is water, where it is permittable. Nuclear is not going to be built at the load centers. So building the robust transmission system is absolutely key and sitting back and waiting for scarcity pricing or LMP signals to have the generation transmission built is simply going to leave us with a very inadequate system.

CHAIRMAN KELLIHER: Thank you very much. That was excellent.

I would now like to recognize Dr. William Hogan, Harvard University, the director of the Harvard Electric Policy Group.

DR. HOGAN: Thank you very much, Mr. Chairman and for the invitation to participate and like many others I don't speak on behalf of anyone else, just my own opinions here.

In the interest of time, I'm going to refrain from the chorus of the communist international, which I don't think I can hum anyhow and I'm not going to look back or try to talk about what we have accomplished or the glass half full. I'm going to try to look forward to talk about what I see as the problems that confront us and in particular confront you and I'm going to try to do that based on responding partly to what I've been hearing with a generic observation and then four specific points about things I think you should take up.

The generic observation is consistent with your opening remarks about the fact that this is not about deregulation. The CATO model of the world where we abolish the Federal Energy Regulatory Commission is not desirable and not in the cards. And the challenge here is to deal with the balance between regulation and competition and markets and there's tremendous pressure all the time in that process to distinguish from what I would call little r regulation and big R regulations. Now by little r regulation I mean setting up the rules and the incentives as best we know how to do them and this fundamentally a market design problem and then allow those incentives to unfold in ways that Phil Sharpe was talking about and so forth, which was not to be prescriptive about what we should be building, investing in and so forth, but rather to set up the rules and the regulations.

And the big R regulations is the opposite, which is creeping integrated planning where basically the Commission says we need to build more transmission now on this scale of this type and charge everybody for it by socializing the cost across to everyone. Why do we need more demand side programs here now with three-year auction contracts or we need all of these kind of prescriptive things and those problems feed on themselves because when you start doing some of that, then it creates difficulties that require you to do other things like that and it's a slippery slope problem and I think that's the fundamental generic problem that the Commission faces is deciding how to distinguish those and then what to do in order to choose the little r option when it can and not to resort instantaneously to the big R approach of regulation.

There are lots of problems. The symptoms are out there and concerns about resource adequacy and infrastructure investment. I'm not going to go through that,a but let me suggest four actions. This is not exhaustive, but it's four things that I think should be on your mind right away and that illustrate this tension that I talked about between little r and big R regulation.

First, in making these choices about what goes in the tool box on your desk and you're not going to deal with, I think the Commission faces a problem everybody always faces and I'm not sure that we've always made the right choices, but I think there's been a very strong tendency when a problem arises not to diagnose where does the problem come from and then try to fix the underlying difficult, but rather leaping almost immediately to the big R solution.

An example of that is this scarcity pricing problem, which you've heard about from many places and I've become convinced that the core problem with that is we under estimated how difficult it would be to get demand side into the system and we did not set up a set of rules in the real-time spot market to provide the right prices incentives because didn't think it was going to be that important because the demand side was going to take care of it, but it hasn't. It's a chicken and egg problem. You have to set the rules. Somebody has to set the rules. This is a regulatory problem and in particular I would focus on operating reserve demand curves. This is in the real time the next few minutes I'm talking about the 15 minutes or something much like is done in the New York system. Mark Linchcomb talked about that.

And the critical issue there is that the prices, when we get into scarcity situations, are dramatically too low under most of these systems because we don't reflect in the operating reserves the pricing of those scarcity. In principle, the way it's done in New York is much better than any place else, but the way it's done in New York the prices are still low by an order of magnitude and that's not -- the other order of magnitude, which is two orders of magnitude that gets to what's implicit in these resource capacity markets that Paul Joskow talked about before -- that is a problem that is unavoidably regulatory. Setting the operating reserve demand curve is not going to be done by the market. It must be done by the ISO or the FERC or somebody and it's been set at too low a price for the critical hours. It creates the missing money problem. It doesn't provide incentives enough for renewables. It makes it hard for wind in general. It ripples through the whole system and it's something that's fixable and can be done in a relatively simple way. And we know it works because it works pretty well in New York if they would just raise the scarcity prices.

Second, transmission investment, which we've heard a lot about, I think the fundamental problem is setting a boundary line between what you're going to let markets do and what is going to be a big R solution from the regulator where you're going to mandate that this transmission be built and the cost be socialized and we've not given enough attention to how to set those boundaries so that we don't create a system which undermines everything else. And I won't go into all of the details here, but I just say there's a model from the way it was done in Argentina, which was actually quite successful at addressing the question when does the market fail and when can we let the market operate for transmission investment and when do the regulators fail and we can defer to the market participants even though we think they're wrong, which is an important question to be addressed in this big R case. And I'd be happy to talk more about how to do that and what ought to be done, but I think we've given anywhere the appropriate attention to that problem and that transmission investment.

The third one which I mentioned is something new and I don't know how it's going to come out, but it's this 9th Circuit decision on the enforceability of contracts. And I don't know if that's off the table because it's in front of you or something, but I'm just a professor.

(Laughter.)

DR. HOGAN: I don't know how exactly to deal with it, but I know what the answer has to be and the answer has to be that somebody can enter into a contract with a customer and later the market turns against the contract with the customer and the contract is enforceable against the customer. If that's the answer, then all this conversation is worthwhile. If that is not the answer, who are we kidding. So if we want to have long-term contracts and so -- now the mechanism for doing that, there are lots of ways that you can imagine approaching that, but that better be the answer. And if it's not the answer and you can just walk away from these things, then how do you get any of these long-term contracts to mean anything unless we go back to big R regulation ratebase, you're going to have to trust the regulator to do it for you later on.

MS. PAUL: One minute.

DR. HOGAN: The last one is a problem which is a creeping problem, but it relates to these RTOs and organized market. To the extent you don't solve these other problems, to the extent that you're mandating and socializing the costs, the best place to be is right on the edge of an RTO because they'll take of all the reliability requirements for you. They'll provide all the response for you. They've got nice price caps, so you don't have to worry about that too bad and you don't have to pay any of the costs that the regulators have socialized across to everybody. So the thing to do if you're in Maine is leave. The thing to do in all these other places you're going to have to confront this problem. You cannot be socializing the cost across these RTOs and leave them where everybody who's below average cost can leave because they will and they should in their own interest. But it's obviously not in the interest of the country and I think that's a fundamental choice between how you're going to approach these problems, but it should be in the too-hard box. It better be out on the table and something that you're going to deal with. And that's not to mention extending RTOs to other places. But if you allow the current ones to unravel because you lay your costs and mandates on top of them, but you say you can leave voluntarily if you don't like it, well, good luck.

CHAIRMAN KELLIHER: Thank you very much.

(Laughter.)

CHAIRMAN KELLIHER: I'd like to now recognize Tyson Slocum, a public citizen. Welcome.

MR. SLOCUM: Thank you so much and it's a thrill that you're putting on this event and I'm honored that I was extended an invitation to be here today.

I've been looking at the agenda. I'm sorry I wasn't here this morning and there's a lot of very accomplished, very esteemed people, but not a whole lot of other public interests groups and just for the future I would like to make a recommendation, if I may, that it would be great to see more representation from consumer groups because after all this is what the whole debate is about is about what the impact of these policies are on households across the country.

My esteem colleague from Exelon is one of two representatives from that company who is appearing before you today and it would just be nice to not be so alone up here.

CHAIRMAN KELLIHER: Actually, you're not alone and I would dispute you on that.

MR. SLOCUM: Please.

CHAIRMAN KELLIHER: We have a state commissioner who's charged with protecting the public interest in Illinois. We have a state commissioner from North Carolina who is charged with protecting the public interest. So you're not alone. I think the public interest perspective is represented and we look forward to your views.

MR. SLOCUM: Excellent. Thank you.

Well, there's a number of bullet items on the agenda for this panel and so, if I may, I might go through them and attempt to answer them as I can with my modest abilities.

One point is what policies will attract new investment? You know, once upon a time we had an electricity system where utilities had a legal obligation to serve their customers. Of course, there's been a lot of radical changes, so we now are forced to deal with coming up with inventive ways that significantly increase costs to consumers to try to entice new investment and the primary mode of doing that is through an enactment of market-based rates. And so the question is how efficient have they been at attracting new investment and I can tick off a number of huge capital outlays in the last couple of years that were fueled by large earnings from market-based rates that were acquiring existing generation through mergers and acquisition. And in fact, that is one of the biggest uses of capital fueled by these market-based rates is to acquire existing generation and so I'm not sure that that is the most efficient method to attract new investment. It's actually rather inefficient to allow entities to enjoy very large rates of return fueled by market-based rates to acquire generation that was in many cases built and paid for by ratepayers under a regulated model.

Another issue is how to send accurate price signals under this framework and this is one of the most curious things that I have been dealing with in a lot of my work. For example, I was working very closely with folks in Maryland during the debate on a proposed rate increase stemming from a power auction and working to raise concerns about a proposed merger between Constellation Energy and FPL. And what I kept raising with lawmakers and with public interest groups in Maryland was way aren't we figuring out what the rate of return on coal-fire generation selling into a market priced by natural gas? That the rates of return, and I know that I'm not alone in raising these issues. My colleague, the Attorney General in the State of Connecticut, and others have raised the issue of why it is a just and reasonable rate to allow huge rates of return, sometimes approaching 100 percent. Sometimes exceeding 100 percent on generation such as coal-fire generation selling into a market where the prices are the marginal costs increasing set by natural gas.

What type of price signal is that sending to the market to build 40-year old coal-fired power plants or nuclear power plants that may take 10 or 20 years to build if we're lucky? It seems to me a very inefficient system of sending price signals and that is why so much investment has been going into mergers and acquisitions rather than into new generation because of this embedded inefficiency with this market-base system.

The availability of long-term contracts is another bullet point on here and one of the things that deal with that is some of these auctions that we've had in Illinois and in New Jersey and in Maryland. I have to say that I have to respectfully disagree with my esteem colleague from Illinois regulatory commission that the results of the auction in Illinois and in Maryland and in New Jersey were not competitive. They were dominated by companies that have huge holdings in the wholesale market and I don't understand how the Federal Energy Regulatory Commission can allow market-base rate authority to entities that, to me, still look like the old vertically-integrated company. I don't understand and maybe people can explain to my simple logic why Constellation Energy is different from Baltimore Gas and Electric? Why Exelon is different from ConEd. These are unregulated power plants selling power to themselves at vastly inflated prices. That's not inefficiency. That's not a well-function market. That is collusion and anti-competitive and I think we need to examine whether or not or why the Federal Energy Regulatory Commission is deemed those to be adequate competitive and deems those power plants to be worthy of charging market-based rates.

-- utilities, either that own power plants or are forced to purchase power and these have been enormously successful in increasing America's reliance on renewable energy. So I would say that the market hasn't been successful and I think it's important to note that several years ago I heard a lot of rhetoric from the industry that these competitive markets were going to result in a robust environmental generation industry and I haven't heard a lot of that anymore. Instead what I've seen is more focus on renewable energy standards.

Another bullet point here is transmission congestion and a public citizen participated in a conference yesterday that we partially sponsored and some numbers were presented from a number of people showing that there has been more transmission investment in regulated areas of the country than there have been through RTOs. So I think that it shows that there is greater ability in these regulated markets to make the necessary and important investments in reliability.

And I must respectfully disagree with my esteemed colleague from the New England ISO who appeared to be critical of the concept of NIMBYism. Not in my backyard as being an impediment to necessary construction. I personally am believe that NIMBYism for all of it's -- it's been heavily maligned -- it is, at its core, an expression of basic democratic principles. We currently have 160,000 Americans fighting overseas to defend our rights here at home and those rights include the rights of my neighbors to have adequate say into what types of energy infrastructure projects get developed in their communities.

We can adopt the communist Chinese model of allowing no input whatsoever and as a result China is incredibly efficient at implementing energy infrastructure, but thank God I was born here and live in a system where my neighbors can have adequate say.

I've got other things to say but I'm out of time and I look forward to your questions. Thank you very much.

CHAIRMAN KELLIHER: Thank you very much.

I'd like to recognize James Brew with Brickfield, Ritz and Stone on behalf of the Steel Manufacturers Association.

MR. BREW: Thank you, Mr. Chairman.

SMA really appreciates the invitation to appear here today. And just a little background, we are the trade group for the North American Steel Makers that use electric ar furnaces to recycle and scrap steel. Of the 100 million tons of steel that were made in this country last year, 60 percent of it was made with EAS. It uses a third of the energy and emissions is making from RPM coke. We operate in real competitive markets. In addition to the 100 million tons that we produced, another 45 million tons was imported from China, India, Brazil and other countries.

Every two years China creates enough new steel-making capacity replace the entire U.S. production. Energy is a big part of our costs. Over 15 percent of our operating costs are in energy. But more importantly for today's discussion, we operate facilities in 38 states, including the organized markets. We're in Illinois. We're in New York. We're in New England. And those markets that are not organized. I have not done a counter-factual study of the benefits of the markets, but I can tell you that among our members they're happier with their prices and service and their utilities in Alabama than they are in the organized markets.

The challenge, as I see it, for the Commission going forward is it has to establish substantiable structures for mitigating scarcity pricing. In the organized markets, we're working with a system that encourages as much scarcity as you're willing to put up with, whether it's RMP, price mitigation measures or whatever. The two biggest things that the Commission needs to address going forward is (1) to greatly expand demand response and (2) to address transmission congestion.

There was a discussion earlier of last year in August PJM called on its demand resources and generated about $650 million in energy savings for $5 million worth of payments to the participants. The real interesting question is what happened the rest of the year. The demand response came from being called by the RTO, not from demand being fully engaged in the energy markets. In fact, the demand response programs, even in the markets that are most aggressive on demand response, is really into capacity and avoiding emergencies, not really interacting on price.

So while the Commission has done a lot lately, particularly in Order 890, with promoting demand response as a resource in ancillary services in transmission planning, you really haven't engaged it as a full resource.

Now I also recognize that a lot of this stands with the states and there's a big part of this is that you can give price signals through LMP to the generators, but the vast majority of customers see an average cost price. Prices go vertical because demand doesn't respond to what's going on in the markets. It's not something that the Commission can directly address, but you have to recognize it as a real impediment on how well the markets are functioning.

The one other thing I wanted to discuss on demand response is, in the past we've worked very successfully with the utilities. We offer over 3000 megawatts of curtailable load, over 1600 megawatts of it on 10 minutes notice or less. But we have real problems in getting two programs passed through the RTOs. One quick example is last year the Commission approved a settlement in PJM to allow bathed loads like steel mills to participate in the synchronized reserve program and that was great. Many steel mills provide that service elsewhere and they were perfectly capable of providing it in PJM. The problem was it took a year and a half to get there.

After eight months, PJM adopted a program that expressly excluded those loads and it was only after we brought it to the Commission that they had to go back and redevelop that program for the loads. A big part of that is RTO governance is slanted towards generators. In New York, it takes 58 percent to pass a resolution. Well, utilities, generators and other market participants control 63 percent of the votes and end users only 20. If you really want to see expanded demand response (1) is you have to inter-react more completely with the states and (2) is you have to reform the RTO governance.

In that regard, I note that the collaborate discussions that you've been having with NARUC and the recently announced technical conference on demand response and wholesale markets are productive, but we need to translate into policies that we really engage loads in the markets.

The second is the lack of really any consistent federal and state being in sync on transmission congestion and planning. And for that I wanted to go back, way back to

PURPA 1978, which gave the Commission authority to order transmission services. The problem was you could only issue that order if it would preserve existing relationships. The Commission moved on from there, as you recall, before Order 888, using its discretionary authority. And in one notable case, the Commission approved the merger of NU and Public Service of New Hampshire where it required NU as the merged company to provide open access, including expanding its grid to allow for third-party access.

And you said, well, what if we can't? What if they won't let us, meaning the states? The Commission's initial response was to say, well, we'll call a technical conference. We'll bring the parties together and we'll get it resolved appropriately or maybe reallocate the transmission capacity. Well, on rehearing, the Commission thought better of that approach, decided it would do what it needed to do through pricing and that's pretty much the way we follow through the evolution of the organized markets. So the problem is, is that the states have to do the work on citing the resources, but the Commission's policies don't really engage the states on transmission planning and expansion.

What I'd really suggest that the Commission take a look at is there was a 2002 National Governors Association Taskforce report on transmission planning and expansion where it recognized that you often have a jurisdictional impasse on what needs to be built and where with respect to transmission and it recommended a couple of specific things. One is that you look collectively at low impact resources, upgrading existing pathways in particular and developing multi-state organizations to work with the states on planning and I would suggest that we take a close look at that.

The RTOs, just as they did in demand response, have a slant to pay the generators first and one of the ways in which I think we've gotten off track in developing the wholesale markets is that the state's role to the RTO has become largely advisory, yet they have to do the work on transmission pricing.

So just to sum up, what we would recommend is that the Commission has to take a more aggressive role on demand response.

MS. PAUL: One minute.

MR. BREW: Not in terms of picking a number, but in terms of removing the barriers at the RTOs and reflecting the fact that it's exhausting for loads to try to get the state commission to say that you can bid in, to get the Commission to approve the program and then have to work with the various working groups at the RTO that don't want to see more competition. What you have the potential for with, like PJM demonstrated with the $650 million savings in one week, is there's a whole lot out there. But the rules that are being set up basically say we'll use demand response when the system's stressed and so you don't get price inter-reaction in the first place. Thank you.

CHAIRMAN KELLIHER: Thank you very much.

I'd like to now recognize Angela Beehler. Is that the correct pronunciation, Beehler?

MS. BEEHLER: Yes, sir.

CHAIRMAN KELLIHER: With Wal-Mart Stores. Welcome.

MS. BEEHLER: Thank you, Commissioner. Thank you for the opportunity to speak about Wal-Mart's very positive experience in competitive markets. With the Commission's permission, I will be filing more extensive comments for the record.

Wal-Mart operates in a furiously competitive marketplace. Our efforts and successes at delivering low prices for our customers are well-known. Effectively managing our energy costs is one important element of that corporate objective. The greater our ability to do so the more competitive we are and the greater benefits realized by our customers, our associates and our shareholders.

Today I would like to address how competition both helps to more effectively manage our energy costs and how it is also a powerful weapon in effectuating the nation's energy policy. In addition to Wal-Mart's 2700 stores in 13 countries, Wal-Mart has over 3900 facilities in the U.S. This year we are forecasting over $2 billion in utility costs. In our experience, competition has proven to be one of the most effective ways to manage these costs. Wal-Mart currently participates in 26 competitive electricity markets in 13 states and in 42 competitive gas markets in 17 states.

A loud, but unrepresented, choirs of voices has argued that competitive markets do not provide savings or benefits to customers. These voices do not speak for Wal-Mart. Last year alone in these competitive markets, which are supposedly not delivering benefits to customers, Wal-Mart mitigated $10 million in electric costs and $10 million in gas costs and these savings do not even include New York and Texas, two of the best competitive markets in our opinion. The New York's competitive platform has been especially successful because New York utilities have, for the most part, exited the generation business.

We are not alone this endorsement of benefits of competition. On December 4, 2006, 7-11, Archdiocese of Chicago, A&P, Best Buy, Big Lots, Chemistry Council of New Jersey, Federated and Wal-Mart, representing almost 14,000 facilities and $8.5 billion in annual electricity costs sent a letter to the FERC declaring our support for competitive energy markets. The Compete Coalition, representing 150 members from all sectors of the economy also endorsed the benefits of competitive markets. All of these companies and many more are the direct beneficiaries of this Commission's competitive policies.

We urge the Commission to hear our voices and to continue to push its mission of competitive markets. Wal-Mart appreciates the various pricing structures offered to competitive suppliers to meet our specific needs instead of a standard utility tariff. These instances of exceptional customer service are not limited to the so-called restructured markets. We have also observed how competition incents municipal and rural electric providers to earn your business also. Having facilities in every state gives Wal-Mart the ability to compare retail choice states to non-choice states. We know what's been successful and what can be improved. There is no perfect model, but the choice states in which Wal-Mart participates are providing benefits. There is every reason to expand competition to even more states based on these success stories and no justification for eliminating competition where it has delivered benefits to Wal-Mart and many other customers.

On renewable power, Lee Scott, our CEO, announced in an inspirational corporate objective of Wal-Mart ultimately getting 100 percent of its power from renewable resources. We applaud the FERC's continuing efforts to facilitate renewable deployment. Wal-Mart believes that increased customer choice facilitates investment in renewable resources.

In general, the Commission can continue its further development of renewables by allowing customers to purchase directly from these sources, allowing customers easy access to the grid, avoiding Pancake transmission costs, encouraging flexible pricing provisions and allowing customers to receive the full benefits of environmental attributes of these transactions. Developing a consistent definition renewables and consistent RPS would reduce the 50-state learning curve and would also optimize renewable development.

Private generation investment has also had a positive impact upon customers. The cost of competitive power are not included in the utilities ratebase. Developing new generation through competitive processes rather than through traditional ratemaking is also critical. We salute the RTOs and ISOs which have delivered benefits such as eliminating Pancake transmission charges that are scheduling of transmission lines, coordinating system expansion and maintenance and increasing economic dispatch of generation and fostering competitive markets.

Some allege that customers are bearing the cost of competition. The cost some attribute to competition are not caused by competition, but rather by the inequities built into the existing system and rate freezes. Wal-Mart contends that allocating customer cost among customer class is based on true cost-of-service is not only fair, but more importantly, creates a more transparent electricity market, reduces prices to customers for all products and results in the best long-term interest of all electric consumers.

The best way for regulators to incent energy efficiency and conservation in through clear price signals and time-based pricing. By contrast, rate freezes and RSP also do not lower rates. To the contrary, they are merely delaying increasing rates, masking the actual higher fuel or purchase power prices the utility is really paying. Rate freezes and other levelizing artifices amount robbing Peter to pay Paul. At a certain point you've got to pay the piper as evidenced by the recent rate shocks that occurred in Maryland, Ohio and elsewhere. And even though competitive sellers should have a price advantage during a rate shock, the customer may be locked in as the utility customer. Or even worse the competitive seller may be forced to exit the market when the rate freeze is in place.

Transmission congestion -- putting a price on transmission constraints has brought transmission congestion to the attention of many concerned consumers. We may not always like the prices, but making those prices transparent encourage innovation and creativity at the customer level and ultimately leads to the prudent uses of constrained transmission and generation at the macro level.

MS. PAUL: One minute.

MS. BEEHLER: The need for energy efficiency and demand response -- demand response encourage energy conservation and reduces grid congestion. We've found the most successful programs in the RTO/ISO regions, which incent customers to make the right choices about their energy consumption. Best practices and consistency across markets should also be shared. Competitive metering also supplies benefits. The choice of metering customers can better monitor to manage their energy usage and participate meaningfully in demand response. At the very least, the utilities should give customer access to the information from the utility-owned meter without charging customers for retrieving their own data. If information is key to informed choice, charging a customer $25 to $300 per account for the customer's own usage is a barrier to competition.

To conclude, Wal-Mart embraces competition in our retail business. It makes us better every day. Why wouldn't it be just as good for the electric power industry as it is for us? Our ability to control costs by participating in well-structured competitive markets has helped us maintain low prices for our customers. Our message to the Commission is simple keep pushing competition. If you do, the utility industry will become more efficient, long-term cost will be driven down and this will pass through to the overall savings to the general public and everyone will win. Thank you very much.

CHAIRMAN KELLIHER: Thank you very much.

I think we can go with nine minutes per person, but let's really try to stick with that and that just puts us slightly over. So I will commit to nine minutes as long as the clock hasn't been running while I've been saying that.

(Laughter.)

CHAIRMAN KELLIHER: Let's go. I have a couple of questions. I'd like to follow up on something that Roy said. You seemed to suggest that we have three different competitive wholesale market structures in this country. We have the Day Two RTO, the Day One RTO and the bilateral markets. You seem to suggest that you think the Day One RTO is the best structure. Now I think we started this review recognizing all these different structures. They're likely to continue and that it's not our job, frankly, to pick a structure and try to superimpose it on the rest of the country. But I wanted to clarify, first of all, that you're saying you think the Day One RTO is the best structure.

MR. THILLY: I think the Day One RTO is very important for regional operation of transmission, regional planning of transmission, single system operator for reliability. I think you can layer on top of that a balancing market, which is important and much more complex -- much less complex.

CHAIRMAN KELLIHER: You think SPP has it right?

MR. THILLY: Yes, I think SPP is a better system than what we're dealing with in the Midwest. I saw that recently that they -- MISO has been struggling with the cost benefits study. They finally came out with a benefit study without offset to cost apparently and the numbers are very low. Now admittedly, that's the start up. So hopefully, it will get better, but from our perspective, we're very skeptical that there are significant benefits to end users through that market.

CHAIRMAN KELLIHER: Isn't it hard to quantify all the benefits. I mean some of the benefits will be qualitative. If you look at the Midwest, in the Summer of '98 or '99 when you had price spikes involving a fairly small number of transactions, but very high price spikes, in part, that was governed by the complete absence of any transparency on prices. What was the wholesale power that summer? It was what the person at the other end of the phone was quoting you. Now you certainly have greater price transparency in the Midwest. It's hard to put a number on that. What is that greater transparency worth? I'm a lawyer, so I don't know how to quantify it. I suppose someone could, but it seems that all those qualitative benefits, again, hard to reduce it to a number.

MR. THILLY: Absolutely. The analysis is very difficult. But if you remember back to '97, there were five nuclear power plants out in Illinois and Wisconsin when that price spike occurred. That was a very, very stressful time. Since that time, we have built significant generation. Part of the basis for building that generation is the base-rate recovery that utilities are getting from the coal plants in Iowa, in Wisconsin where the regulators provided certainty and those investments are being made. Without that, the only response to those high prices would be to put in gas units and we would not have the fuel diversity that we have.

When I hear the argument that scarcity prices are too low and that's the problem, you know, I just recoil. The only advocates I see for scarcity pricing is (1) the people who get the windfall profit who collect the scarcity price and (2) academics. And I read an article in the New York Times recently about economists getting together and deciding that the most efficient gift for Valentine's Day is cash.

(Laughter.)

MR. THILLY: And there are unintended consequences.

CHAIRMAN KELLIHER: Okay. Let me follow up with Dr. Hogan, an academic.

(Laughter.)

CHAIRMAN KELLIHER: First of all, if you look at these three market structures, do you accept that we're -- I don't think we're posed to try to impose a certain design. Do you regret that? Do you disagree that the Day One structure with the balancing market is the best way? Do you think the Day Two is the best way presumably?

DR. HOGAN: First of all, I always give chocolate.

(Laughter.)

DR. HOGAN: And I always use blank cards so I can write my own poems. Just for the record.

(Laughter.)

CHAIRMAN KELLIHER: Nothing like a romantic.

DR. HOGAN: I think, to the extent that I understood everything that Roy said about that, I would agree that the Day One structure or the critical part is the balancing market and I presume that means an LMP-based balancing market following everything that Betsy Moeller said with the illumination of commitment. So it's just an economic dispatch and rebalancing and so forth, but not the commitment decision. I think that's necessary and I use the word advisedly. I don't think it's an option. If you want to have a nondiscriminatory system and you want to have these things work, so it's necessary. So you have to do that.

Now the question is should you do more than that is something that you could decide based on the preferences of the parties and the cost benefits. And I think the answer can be different in different situations. A good example of a place where it was different was in the early days of PJM where that's what they did in the early days. They had that kind of a system and then the market participants said this is a problem because we can't do the scheduling. We can't hedge Day Ahead. We want the Day Two structure so that we can deal with it.

In New York, they had a different situation where they didn't have enough fast-starting peaking units around. It was just a physical problem, but they had to have big units committed Day Ahead in order to keep the lights on. So it was just a different situation. So they decided they had to have both the Day Ahead and the real time at the same time and launched at the same time and I think that was the right answer there. So I think it depends on the facts, but the balancing market part of the story is necessary.

CHAIRMAN KELLIHER: Do you think all three structures can be equally competitive or do you think some are inherently more competitive than others?

DR. HOGAN: The bilateral?

CHAIRMAN KELLIHER: Bilateral, Day One, Day Two.

DR. HOGAN: Well, the bilateral, without the balancing market that I just described, doesn't meet a necessary condition. So the answer is no, it can't be. It has to be discriminatory. It better be discriminatory. To tell you the truth, I don't want a bilateral system which is not discriminatory because the lights will go out because the system operator has to make a lot of decisions which are going to be very difficult to quantify and mechanize and advance it. If he's not discriminating, we're in trouble. So they'd better be. The only system which doesn't have that problem is that when you do the ex-post pricing and the balancing market that reflects what the system operator is doing and that's the LMP system. That's the only one that's consistent with what they're doing that's not discriminatory.

So A, it's necessary and B it's better if you want to have these competitive markets and the Day Two is a factual question that depends on the circumstances and the preferences of the parties.

CHAIRMAN KELLIHER: Let me ask another questions about lack of entry. Why in New England I think it was in 2004 we saw peck demand rise 2700 megawatts and there was 11 megawatts of generation addition into a system that already had fairly low reserve margins at the beginning, and this is really directed towards Gordon as well as Dr. Hogan. Why did we see that? Was it the lack of forward market? Was it over mitigation? Was it the lack of scarcity pricing? Why did that happen because it seems counter-intuitive very limited entry, demand increasing very noticeable?

MR. van WELIE: I think the biggest jump in peak we saw was just in this past year and I think the figure you quoted is probably over a couple of year period. I think probably the biggest reason was we were still in a surplus position back in 2004. So if you look back at what happened is we were short. We went in two markets. You've got this big surge of investment. We had an overbuild and we had problems with the capacity market. So investors wouldn't have been making a rational decision to go and build generation at that point.

If you look at our regional system plan, we were forecasting that we would go short in the 2009/2010 timeframe, which is we're going to be getting to this full capacity market just in the nick of time. So I think it's only now recently. So we saw interest in building in New England decline rapidly and we can see that through the queue, which is a leading indicator and we've seen, since we've got certainty around the fully capacity market, that queue jump out again. So it's a signal that people are interested in building in New England and they believe that we will be short in about two or three years.

CHAIRMAN KELLIHER: Thank you.

Dr. Hogan, do you have anything to add?

DR. HOGAN: I think, in addition, if you look at every one of these capacity market studies that have been done and I think I've read most of them, if not all of them. The one common feature they all have is they all come down to the missing money problem. That's not the only thing and there are other features, but that there is not enough money in the energy market in real time to justify the investment going forward and that's related to the scarcity pricing problem and fixing the scarcity pricing problem, I think contrary to what Roy says, benefits what many people, particularly the demand side participants and the renewables and the wind and everything else. But I think it's necessary in order to mitigate a lot of these problems.

Now it doesn't necessary eliminate all of these other problems. That doesn't mean capacity markets go away, but they become much less important in a much less mandated and cost spreading go out. So I think that's a fundamental problem.

CHAIRMAN KELLIHER: Thanks very much.
Colleagues? Commissioner Kelly?
COMMISSIONER KELLY: Thank you.
Bill and Gordon, are you talking about the same thing? When Gordon mentions in his testimony the concern that you have about the structure or the lack thereof currently in place between the two markets and the price signals, are you talking about scarcity pricing in particular?
MR. van WELIE: I think we're overlapping. So I think what he's referring to is the scarcity pricing the wholesale market. What I as referring to there was the fact that the retail level that price doesn't get through to the end consumer. So that becomes a real problem. If you're trying to incent end consumers to reduce their consumption and you're giving them a flat price that doesn't reflect what's going on in the wholesale market. So that's one of the issues that we have in New England. We've been advocating in some of the state proceedings recently to have the states move to some form of dynamic price increase or peak pricing. Something that is more reflective of what's happening from a cost structure point of view in the wholesale market and we think this is one of the big barriers that still exist out there.
COMMISSIONER KELLY: Are there any smart meters

in place in your region or programs to introduce smart meters?

MR. van WELIER: It's basically driven utility by utility, so it's a bit of a chicken and egg situation. I think one of the utilities that's most progressive in this area is National Grid. All the utilities are doing something. I think it's more focus on industrial and industrial consumers.

Why I say chicken and egg? I think the two elements go together. If you can get the pricing of three at the retail level through the retail rate design and you couple that with some kind of technology that allows the consumer to see the price and then link that back to devises in their home or their office or their business, that's when you'll start getting true demand response that goes all the way back through to the wholesale market. And so there's only so far you can go at the wholesale level, particularly in a place like New England that does have very large industrial loads and then you've got to ge below that.

COMMISSIONER KELLY: I'd like to ask Jim and Angela, in your experience in trying to integrate demand response into your business, has it been a technology problem integrating it or a retail regulation problem or a wholesale market problem? What's the primary basis?

MR. BREW: Ten years, if you asked the steel maker if he'd interrupt, he'd say you're nuts for not making tons. It evolved to, yeah, I can interrupt on a Day Ahead signal, but we can't do it otherwise. Now, as I mentioned earlier, there's about 1600 megawatts of steel load that's curtailable on 10 minutes notice or less and some of it is the utility has to switch and it's the result of, for the most part, us working with the utilities on what you can do.

You also have to understand, apart from tariffs, there are a lot of times when the system operator would call the steel mill and ask them to ship their production. So it's been an evolution of learning how to do it and that means upgrading your equipment, upgrading your demand controls, inventory control. There's just a whole lot of things, a whole of costs that goes into doing it and so it's been an evolution over time. You can't just walk into the markets. You have to be ready to play.

COMMISSIONER KELLY: Thank you.

Angela?

MS. BEEHLER: At the end of 2004, we really wanted to get ahead of the curve instead of waiting for a utility bill to come in 45 days and figure out what happened to your energy during the month, so in that time we started looking for a meter that would fit our different sized prototypes or all of them and work with our energy management systems we've had for 10 years. And while we did that, we finally ended up going overseas and getting a firm to come in and work with us to what would work best with our business. We finally have used it with a meter that goes down to the sub-circuit levels within our stores. And therefore, it coordinates with our EMS system, but we found in many of the demand response areas across the country, it also works very well with communication with just about any utility system out there.

We're currently working with some of the laboratories that were mentioned earlier showing them what our systems can do. But yes, we can respond. Yes, we can respond better with additional meters, but you need to realize it's important to incent the customer to cut the additional loads you need. Customers or businesses are going to have sales impacted to some degree. The customers are a little bit warmer. They don't want to go to the back of the store to get that extra gallon of milk, but you are doing the right thing for the community and we do like to do that as well. So you have to balance those instances. But when the customer is incented and it offsets a little bit of that, you can really participate to the full amount possible.

COMMISSIONER KELLY: How has your experience been in trying to implement these in your stores across the country?

MS. BEEHLER: Right now we have them over the State of Texas. We're getting ready to roll them out in another successful state that we enjoy working with. As a matter of fact, our base meter without the sub-circuiting we put in Connecticut first because of their benefits that they provide to customers and in sync customers. And because of the demand response participation we were able to participate in last year, it has paid with the next level of meters with the sub-circuit to go back into those meters this year or next year.

COMMISSIONER KELLY: In states were retail loads are not competitive, have you been able to implement this program in those states?

MS. BEEHLER: We do participate in some demand response that are non-choice states. We do see more benefit in the competitive states through the ISO and RTO demand response programs. Those are the most beneficial ones we've found.

COMMISSIONER KELLY: Would it be helpful if the federal and state regulators worked together and the other states to come up with an approach or to educate ourselves about the best approach to take to make it easier?

MS. BEEHLER: I think that would be excellent. I think the more best practices we can share across the lines -- the successful programs that you read about in the trades that are really producing these megawatt reductions in constrained areas, let's share some of that positive feedback with other states. If they really want to make a difference, I think we can.

COMMISSIONER KELLY: Bill, I wanted to ask you about one thing that you mentioned. Your concern about the ability of utilities, transmission owners to leave RTOs if they're on the edge. Is that because you're concerned about the free-rider issue?

DR. HOGAN: Exactly, yes.

COMMISSIONER KELLY: Do you think that that occurs?

DR. HOGAN: Well, there's been companies applying to leave. I know there's discussions -- I mean I've read about it in the papers. I'm not participating in it, but there's discussions in Maine about leaving the ISO New England. You can ask Gordon. This is a constant -- I mean, to a certain extent, it's a good thing to have pressure on the heads of these ISOs. They have voluntary participations, but when you start mandating and taxing, you know, and you just say, hey, you know, we had a civil war over this. Right.

(Laughter.)

DR. HOGAN: Eventually, it just gets to be too much.

CHAIRMAN KELLIHER: You're lucky Commissioner Carr left the room.

(Laughter.)

COMMISSIONER KELLY: We're going to have a technical conference later in the spring to look at these issues and I would really appreciate the benefit of your expertise if you're interested. A lot of it is tied up in contracts, which, of course, leads me to the other issue that you raised and that's the sanctity of contract issue.

I understand sanctity of contracts implicitly when it comes to prices paid for supply and demand, and investment being based on that. How about contracts for the ability to leave RTOs? Would you want to see the contracts make economic sense? It sounds to me like you'd want the contracts to make economic sense such that there isn't a -- to the extent that there's a right to leave. There isn't a free rider problem here.

DR. HOGAN: I prefer voluntary to mandatory and voluntarily enter into contracts to mandated regulations. But there are some things where you need big R regulations and that's one of the whole points of big R regulation is you can use mandates. The whole point of that is to overcome where people don't want to do it and when you're socializing the costs and it's going to get worse -- this problem -- because of the transmission investment and these capacity markets and so forth. If you don't fix the other problem and get more of it into the energy markets and the market prices, then just more and more of it ends up being in this peanut butter that gets spread across to everybody that really doesn't pay or at least wants to make sure it's spread very widely. I think that's a fundamental tension that you have to deal with.

COMMISSIONER KELLY: Thank you.

CHAIRMAN KELLIHER: Colleagues?

Mark?

COMMISSIONER SPITZER: Thank you.

A couple of questions for Commissioner O'Connell-Diaz. First, I appreciate that the Chicago Cubs in Wrigley Field have an alternative supplier, but reversing the goat curse is beyond the power of this commission in terms of the Cubs winning the World Series, perhaps your commission.

MS. O'CONNELL-DIAZ: I have my rosary beads out.

COMMISSIONER SPITZER: My son in his hockey game gave up a couple goals. His team gave up a couple of goals early and instead of playing harder he asked for a do-over. That's the way with kids. They want do-overs sometimes and there have been some folks who have called for a do-over. But as I recall from our meeting in Arizona a couple of years ago, you were an ALJ at the Illinois Commerce Commission in the OLJ regime, so to speak. Is that right?

MS. O'CONNELL-DIAZ: Correct.

COMMISSIONER SPITZER: If we had declared a do-over -- if the Illinois legislature had declared a do-over and you were presiding over the rate cases, would the results be materially different than what ultimately ensued?

MS. O'CONNELL-DIAZ: Well, first of all, it's up to the legislature to determine the rules on the boxtop. The rules on the boxtop have not changed in my state for 10 years, albeit, for the extension of the rate freeze, which is a whole other issue, rate freeze. So it would be my job and it would also be the companies or anyone's job to argue under that legislative battle that we're working under. Would the results be the same as we're sitting here today, post-auction? I don't know. It would depend on any kind of procurement model. Sitting here today, I would not be able to answer what the outcome would be.

COMMISSIONER SPITZER: But if it were under the old cost-of-service regulation. It does call for some speculation by you.

MS. O'CONNELL-DIAZ: Would customers be paying more? Is that the bottom?

COMMISSIONER SPITZER: Would there be a material difference?

MS. O'CONNELL-DIAZ: I think customers would be paying more and I think, if you look at the backdrop of states that are still under the old regulatory model -- and that is their right. They believe that that's correct. I think that there are economies that have been afforded, through restructuring, that we are enjoying. And I think the bantering about with regard to the rate shock when you have rate freezes that go on for the extent of time plus reductions in those rates you disconnect the consumer from what their real cost is. And if you do that for a long period of time, you've got a big mountain to climb. So I think, if I look at the figures that are out there for states that have not restructured and our state, I think we're in a better position than we would be without it.

COMMISSIONER SPITZER: When I fled Arizona for Washington, we had four rate cases in front of us by one utility based on natural gas costs. So you question whether the do-over would reverse the outcome.

MS. O'CONNELL-DIAZ: And companies don't come in because they want a rate reduction. Right?

COMMISSIONER SPITZER: That's been my experience.

MS. O'CONNELL-DIAZ: So there would be many rate cases.

COMMISSIONER SPITZER: Sometimes you've got to call them in.

MS. O'CONNELL-DIAZ: Right.

COMMISSIONER SPITZER: Speaking maybe more broadly for your colleagues, there's been a lot of discussion about the SM. It's bene my experience that the low-cost jurisdictions have less incentive, not only as a commission but within the political context of that state to employ different types of measures and that does -- although the cooperation between the states and the federal government -- Commission Wellinghoff and I worked on the taskforce -- is laudable. Where the rubber meets the road -- I'm a Federalist. I respect the states. How would we deal with efforts to have a syncrinist system and yet accommodate the fact that the low-cost jurisdictions simply have less incentive for some of the newer technological innovations. What would be your recommendation?

MS. O'CONNELL-DIAZ: Well, I'm probably not the person to ask because Commission Liebermann is the main response guy and he may have answers to that. I will tell you that we just had a meeting about three weeks ago at the commission with our Midwest colleagues. The sole issue that we were looking at is demand response and how do we get this up and running. Obviously, Illinois has seen the light at the end of the tunnel. We have legislation now that we will be -- the companies are now incorporating in their menu of things that customers can do to connect themselves to their usage and what their bill cost them and using less electricity.

It is a challenge. I don't know what that is. I remember walking out of the meeting thinking how many of these are going on across the states as we speak, these meetings in different areas, and how can we all work together because the end result, the goal is to be more efficient and to save money and increase the amount of supply that is out there. And it seemed to me that there is much conversation, but there is not a lot of doing. So I would commend the efforts. I know that FERC is looking into this.

And Commissioner Kelly, I was going to follow up on your question that you had for one of the other panelist. Our state will be looking at the numbers that are coming out of our real time pricing program and we'd be very, very happy to participate and really come up with a national solution. I think that we have to respect individual states rights, but when you have this type of a modality that can, I think, be deployed in various type of structures we should certainly come up with a -- not a one size fits all, but certainly one that can be tailored.

COMMISSIONER SPITZER: I agree it is a national problem. We need to be respectful to states, notwithstanding.

Mr. Thilly, you and I had some discussions particularly on long-term transmission rights, but both then and today you were very compelling in general observations regarding transmission. I voted for transmission lines and I was an elected commissioner and had to put a line in somebody's backyard and the next day ask for their vote and that required me to communicate to the consumers, both the economic and environmental benefits of transmission. You've had some recent successes I understand. Can you articulate some of what you view as the need to articulate those benefits in order to get the transmission built that need to provide the benefits to the ratepayers?

MR. THILLY: I think it's very important that what is being planned and built is being built for the needs of all of the load-serving entities, users in the area and that gathers a great deal of political support for the construction. And also it means the construction is done on a less-cost basis rather than done for different utilities individual needs and that's a very important part of the story.

I think also that in Wisconsin having a company that is solely devoted to transmission that can't duck. It is one of the most unpopular things a utility does politically and if you have a single focus you can't avoid it and it's the only way in which you grow and also you do a better job because of that single focus. So I think the combination of inclusive planning, meeting a variety of needs and having somebody whose job it is to get it done has been very helpful.

COMMISSIONER SPITZER: Betsy?

MS. MOELLER: I'm hearing this. There's one of these new urban legends born and I'd like to debunk it, if I possibly could. There's this myth that people are not building transmission. I saw a news report last evening by former Washington Utilities and Transportation Commission Chairman Showalter that talked about only 30 miles of transmission being built. PJM has had 230 miles of transmission built in the last three years. They spent $4.2 billion in transmission in upgrades in PJM.

We at Commonwealth Edison spent nearly a billion dollars in the last three years. We currently have a $345 million transmission project underway going under the Chicago River. If you want to see it, come on by. We've got a video, too. But I'm sorry but it is important. It is a very important issue. Planning of transmission infrastructure for all kinds of resources, whether it's Roy's guys out at the end, whether it's demand resources, whether it's wind, it's hugely important. It's best done on a regional basis, but the stuff is getting built. Now maybe we need to do more, but let's implying that nothing is happening. I feel better.

(Laughter.)

MS. O'CONNELL-DIAZ: If I might just add, from my old OLJ days I can recall sitting in hearing rooms when there was a very large ConEdison to a line going up and it was 7 o'clock at night and I had a witness that was crying on the stand about her children and it was in her backyard and she was in a new development and in the area which I live in, which is formerly rural is now 900 homes where there was one farm before. The electricity has to get there somewhere, some way, some how and they do enjoy their air conditioners. They want their videos to work. They want all of their computers to work. So I think that it's really important that the education component is out there and that means that we need to get out there in the communities communicate why this line is needed, what needs to be done, what are the alternatives that were looked at. We normally do that in Illinois, but I think that that -- if you let people know what you're doing and it just doesn't all of a sudden appear, goes a long way to the understanding of the absolute need for it, certainly, on a local basis but in this national forum that we're in today on a national level the reinforcement of our grid is critical to all the small towns across our country. So I think it's an educational component that must be out there and I think we, as regulatory bodies, should work with the various companies that will be providing those services.

CHAIRMAN KELLIHER: Thank you, Commissioner.

MR. BREW: Could I just add on piece on that? One thing I did want to note was in Order 890, the Commission requiring the OATT providers and the RTOs to start doing congestion studies and sharing that information is a really significant development. The RTOs, for example, in New York only does reliability planning. And as Mr. Thilly mentioned earlier, it's not just about reliability. As consumers, we're interested in seeing congestion reduced, too, not that you're going to reduce all the congestion or mandate something, but simply looking at reliability planning isn't providing what the consumers what and I think following up on the order in 890, the congestion studies, should be a high priority for the Commission.

CHAIRMAN KELLIHER: Thank you.

John?

COMMISSIONER WELLINGHOFF: Thank you, Mr. Chairman.

Mr. Slocum, I have a great deal of respect for Public Citizen. In fact, I have a great respect also for its founder, Ralph Nader. I've got this great picture of Ralph when he was testifying in the mid-'70s before Congress and he has this suit and tie on sitting at the table and you can see underneath the table he has a pair of combat boots on. I think the boots -- it was probably a snow day, just to be fair to him.

(Laughter.)

COMMISSIONER WELLINGHOFF: But it was just sort of a great imagine of him testifying before Congress with the suit and the combat boots. But with that, I'd like to give you an opportunity in the couple of minutes that I have. You said you had a conference in the last couple of days and I'd like to know specifically if there were recommendations that came out of that conference or if you have any specific recommendations for FERC how you think we can make the electric system more efficient and the delivery of electric service to consumers more efficient and more effective.

MR. SLOCUM: Absolutely.

First, thank you very much for your kind words about my organization. We have a number of specific recommendations. The first thing is analyzing whether or not market-based rates are, indeed, efficient. I think that there has been a number of lawsuits and policy debates about FERC's ability to effectively assess whether or not a market is competitive and to assess whether or not an entity has market power during hourly and other aspects of a constantly moving market. And I think that FERC has tremendous sophisticated resources at its disposal and yet I think, from an outsider's view, it appears as though the agency is struggling to be able to effectively monitor these incredibly complex markets. That we are seeing results from market-based rates that are not just and they are not reasonable.

So the first order of business has to be assessing whether or not market-based rates is the most efficient way to provide incentives to generators and Public Citizen is not alone in thinking that a more transparent pricing system where prices are more directly tied to costs will produce more efficiencies. I think that earlier there were statistics given that prices in regulated markets versus deregulated markets have both been growing and that is absolutely true fueled by rising natural gas costs followed by rising, you know, uranium costs, coal costs. Prices have been rising in all markets in the United States, but they are rising distinctly faster and there is no doubt about this. There is no debate. The facts from the Energy Information Administration clearly show that rates in those markets where you have full deregulation are rising at an annual average rate of 7.4 percent versus 4.3 percent in those markets where retail rates are still capped or regulated. So to us, we look at that and we see what are the benefits of relying on markets when a regulated system is providing plenty of power for folks at costs that are fare more reasonable. And this is not any sort of complicated formula. These are statistics available at the Energy Information Administration. You don't need an economics degree to analyze what these rates are and the growth in rates have been clear and that's based upon the fact that in a deregulated market costs are tied to marginal costs which are increasingly determined by the price of natural gas. Whereas, in a regulated market, prices are determined on the average cost of all generation types. So average costs have been going up, but natural gas peaker units have been going up far faster and those costs are all immediately passed on and generators that do not have the kind of costs that a natural gas generator does are enjoying windfall profits.

I don't see how that is consistent with the Federal Power Act requirement that the rates be just and reasonable. So that is the primary recommendation.

COMMISSIONER WELLINGHOFF: Let me follow up on that recommendation.

MR. SLOCUM: Please.

COMMISSIONER WELLINGHOFF: How would account then for states like Nevada that were fully regulated, but yet their retail rates have gone up over 60 percent in the last six to seven years?

MR. SLOCUM: A lot of that has to do with rising fuel costs, but if you compare the costs that have been rising in markets such as Illinois, Maryland and other deregulated states, the rates are going up much faster. So having a cost-of-service --

COMMISSIONER WELLINGHOFF: I'm sorry. What I just said to you is that rates in Nevada probably are going up faster than any place else and it is a fully regulated market. So how do account for that based upon your assumptions?

MR. SLOCUM: I'm not sure that rates in Nevada have gone up faster than elsewhere.

COMMISSIONER WELLINGHOFF: The rates have most certainly gone up. There's no question about that. You're suggesting that we analyze it overall.

MR. SLOCUM: I think that would be great. And I think that it would be great -- a question was asked earlier of my esteem colleague from the Illinois Commission about in your personal assessment what would be more successful the system we have now or a system based on cost-of-service? What would be very helpful is if the public and if the Commission had access to a lot of the financial details that the power companies have. A lot of the problem with these markets that we're pursuing now is how proprietary all the information is.

My friend and colleague, Robert McCollum made a presentation at our conference yesterday and he talked about the beauty of full information in a marketplace. We do not have full information. The Federal Energy Regulatory Commission has been taking information out of the public domain. Power purchase numbers form FERC Form 1s are no longer available to the general public. We are removing more and more key information that we need to evaluate the differences between market-based rate systems and cost-of-service rate systems because it's in the direct financial interest of the large entities.

COMMISSIONER WELLINGHOFF: In that regard, Mr. Slocum, I'd refer you to the fact that we did just open an NOI on our Form 1. So if you have any specific suggestions as to additional data that we should gather, please I ask you to comment on that. We'd very much like to know what additional information and data you think we ought to put back on the Form 1, what additional data we should be gathering and making available to the public. That's exactly what we're asking for, so please do that. Thank you.

COMMISSIONER WELLINGHOFF: Mr. Thilly, I had a question for you. Did you indicate that you believe that transmission should not compete against generation demand resources? Did you say that?

MR. THILLY: I think that the notion that every transmission line has to compete against demand or demand resources and generation is not good. I think we should have a baseline for a robust system. That does not mean that we shouldn't be doing as much conservation and efficiency as possible. It also doesn't mean that when I go into justify a transmission line I don't have to demonstrate to the regulator that I am doing it. But fundamentally, for the markets to work, you need a strong transmission system. And if you could opt for a weak transmission system in order to -- just opt for a weak transmission system to get by the minimum necessary, we're going to have all kinds of problems in the market.

COMMISSIONER WELLINGHOFF: I agree with you. I think we need a strong transmission system. We need it for renewables. We need it to deliver renewables into the market and we shouldn't bypass that on the one hand. On the other hand, I think we need to do the cheapest things first.

MR. THILLY: I don't disagree with that. And you know, on the wind side, we just did two long-term wind contracts. You need contracts to get that wind built. It's not prices in the market that are driving it. They can't buy the turbines without the long-term contracts and without the long-term transmission rights.

COMMISSIONER WELLINGHOFF: A quick question for Mr. van Welie.

Did you here Dr. Joskow talk about the asymmetry of prices between generation and demand side resources in the Northeast.

MR. van WELIE: I did and I actually even spoke to him after that.

(Laughter.)

COMMISSIONER WELLINGHOFF: Can we fix that problem?

MR. van WELIE: It's a complicated discussion, so I don't think we've got the time.

COMMISSIONER WELLINGHOFF: If you want to submit something to us, that would be great.

MR. van WELIE: All right.

COMMISSIONER WELLINGHOFF: Thank you, Mr. Chairman. Thank you, sir.

CHAIRMAN KELLIHER: I'd like to now recognize Commissioner Moeller and since Phil has gone last, I think he deserves some extra minutes.

COMMISSIONER MOELLER: I'll be relatively brief, Mr. Chairman.

First, Commissioner, I want you to know I drove 2000 miles in '84 to see the Cubs in the playoffs. So we share a lot of pain together.

(Laughter.)

COMMISSIONER MOELLER: Betsy, I guess I just want it on the record that you and I are not related.

(Laughter.)

MS. MOELLER: It is true. You have too many letters in your last name and I won't tell the story of when you and I and your wife were in the same room. Her name is Elizabeth.

(Laughter.)

COMMISSIONER MOELLER: Booked in the same room.

(Laughter.)

MS. MOELLER: I insisted on my own.

COMMISSIONER MOELLER: Gordon, I'd like to give you a chance to comment on that last question.

MR. van WELIE: Yes, the discussion I had with Paul was what he was getting at was the issue of right at the top of the demand curve the value of those last few megawatts just before the lights go out and it's true that the markets at the moment don't really value that from the perspective of last load. I mean that's actually getting at your point, Bill Hogan's point, which is you were to walk around from the capacity market construct and just go to an uncapped energy market and let the prices go to $20,000 per megawatt hour, you're sending a very powerful signal to demand resources to reduce their consumption. So that's really what he was getting at.

Now we know form our long experience over the last three or four years in New England that that's not a solution that we're going to be implementing. We're implementing this full capacity market. In fact, in some ways it makes demand response a little harder. It has benefits and there are some issues as well. So the benefits are that what we've seen out-of-market demand respond programs there's been an increase from about 200 megawatts in 2000 to about 6000 megawatts about a year ago. Since we've implemented or we've started on the path of the full capacity market and since we implemented the ancillary services market just last October where we're actually making it possible for demand response resources to provide us a peaking service, a peaking generator service, we've seen another 400 megawatts or so coming to the DR market. So there's been a big spike actually just in the last 12 months or so.

The issue, of course, is what you're doing here is from a capacity point of view you're valuing DRE resources equivalently to supply side resources and so the next bit of revenue stream that you're going to be able to offer these DRE resources is in the energy market. One of the downsides of the full capacity market -- and this is something that states fought very hard for and I think it is beneficial to consumers -- is that the full capacity market construct subtracts some of the peak pricing from the energy market from the capacity payment. So you actually get this natural edging effect of $258 per megawatt hour. So consumers, in fact, are protected against that volatility.

So we've actually got two competing policy issues going on here and it's always the same problem. On the one hand you're trying to protect consumers against volatility and against high prices. And on the other hand, you want to incent them to consume less at the right time. So how you actually strike the right balance there is the complication.

COMMISSIONER MOELLER: Thank you.

MR. van WELIE: Did I get that right?

(Laughter.)

DR. HOGAN: I think the answer is yes, but there's another paragraph which is critical, which is in that natural hedging balancing. What you do is you take the incentive out of the marginal price that people actually see when you really need the response and all the other things that have to be done that you can't plan three years ahead of time and you put it in the average price, which is the average price that's going to come out of this forward at capacity market. So the substitution between it and netting out the expected scarcity prices than the capacity trends is logically the right thing to do and these are not mutually exclusive. But what you should be trying to do is get as much as you can into the energy price, the marginal price and as little as possible into this average price over time because that allows all kinds of other things to happen, incentives that ripple through the whole system and are going to affect a lot of other things that are extremely difficult to simulate three years ahead of time in a stakeholder regulatory process even if its run by Gordon.

(Laughter.)

CHAIRMAN KELLIHER: Mr. Slocum, I wasn't at your hearing yesterday, your meeting yesterday, but it was alluded to be or at least passed on that you had called FERC a corrupt organization and I don't know if there's a record of those proceedings, but I thought I'd let you either affirm that or deny it.

MR. SLOCUM: I did use that word. It was -- I think that when a federal body allows the kinds of practices that are occurring right now in wholesale markets I think that that is a kind word to use, and this is nothing personal against any particular commissioner, but it is a practice of allowing rates that are not just and reasonable. The best part of my job is when I get to leave Washington, D.C. and work with communities that are impacted and a word was used earlier on this panel that people in my community are whiners, and I don't think that you can call a family of four making decisions about how to spend their family budget because of rising utility prices at the same time that companies are enjoying some of the biggest profits in their history. This is not about demonizing profit. This is not about demonizing the concept of rewarding hard work, ingenuity and investment. This is exploiting a dysfunctional market.

CHAIRMAN KELLIHER: Okay. I got your point.

I'll tell you there are 1200 hard working public servants here and I don't think they would appreciate your choice of words. So we'll leave that that.

Professor Hogan, notwithstanding your comments on the 9th Circuit, what are your predictions for the various markets going forward in 3 minutes and 34 seconds?

(Laughter.)

DR. HOGAN: My fear is that in avoiding what is admittedly not so easy, the hard work of dealing with some of the problems we've been talking about and hoping they will go away. That they don't go away and that the slippery slope problem continues and regulators everywhere are called on to mandate this and mandate that until we reach a very expensive breaking point where we just can't live with that. The status quo just falls apart and then we have to do something dramatically different and what that dramatically different -- I think it's very difficult to see how we acquire all these assets again and go back to the old system. So I think eventually we'll get driven to something that is much more market friendly, but I the costs, I think, are going to be really substantial because I don't have much confidence that we know enough as regulators and planners to make all of the right investment decisions in the absence of the incentives for all the people in the marketplace. I think the whole point this to decentralize the decisions. Let them take the risks and let them earn the rewards and get the benefits from it. But we aren't there all the way and I see lots of signs on the horizon which keep occurring and it's these capacity markets, which, if you're not going to fix the other problem, you have to deal with capacity markets. I'm not saying that you shouldn't do it, but you can do it in a way that's mutually consistent.

I would focus on these scarcity pricing short-term issues and the ones that I talked about. I didn't go into transmission rights because I think you're on the right path in that direction, but I think that's a critical thing that Roy and others talked about. But if we don't do that and confront some of these really difficult problems, people will opt out of the RTOs. You'll be mandating. It will implode because you'll mandate more costs on the residuals in order to deal with the problems that get created and it's a negative feedback problem. That's the nightmare scenario that I see and I don't see any happy outcome of that without leadership from you and you're human beings. I know we're all have our abilities, but we can't do everything. I don't think this is easy and so I'm not -- it's not that I pretend this is just trivial and go ahead and why don't you just do it. I think it's not easy, but I think there are things that can be done, but it does require leadership from this Commission.

CHAIRMAN KELLIHER: Thank you.

I want to thank the panelist for their help this morning, this afternoon and I want to invite the panelists here as well as the prior panel and the next panel to join us for lunch upstairs. Thank you very much.

(Lunch recess.)

AFTERNOON SESSION

(2:30 p.m.)

CHAIRMAN KELLIHER: We're going to reconvene, if we can close the doors and people can end their conversations or take them out to the hallway.

I want to thank the panelists for being so punctual. You are all here on time and that's great; that's magnificent.

Why don't we start with our colleague, Commissioner James Kerr, Commissioner of the North Carolina Utilities Commission and President of the National Association of Regulatory Utility Commissioners. I really thank you for joining us today, Jim.

MR. KERR: Sure. Thank you, Mr. Chairman. I appreciate the opportunity to be with you and your colleagues again. It's not lost upon me that this time I'm sitting next to the timer, because I think I went about 15 minutes over. So she can kick me under the table.

(Laughter.)

MR. KERR: But we appreciate, on behalf of all of my colleagues at NARUC, we appreciate the Commission's stepping into this matter and conducting this series of technical conferences on this important and timely topic.

I also appreciate your having my colleague, Commissioner O'Connell-Diaz from Illinois. Unfortunately, my plane was delayed and I missed all of her remarks, but I know how good she is, and I appreciate you all bringing her here to address the organized market structures.

I also would just take a second to say that it's been an extraordinarily difficult time for our colleagues who are operating in retail restructured environments, and they are left implementing some difficult -- implementing laws that were largely passed by their legislators, and it's been personally difficult; it's become a politicized situation for many of them, and what you all saw today, is the type of committed professionals that are serving on these commissions in extraordinarily difficult situations, carrying out the laws, much like we all are charged with, simply carrying out the laws that are created for us by legislators.

I also want to just take a brief second to again thank all of you all for your participation in NARUC's meetings that concluded last week. You all did various things, even Commissioner Moeller with a very bad head cold, was there, and we appreciate your support of our organization and the continuing quality of the working relationship.

I would also say that because I was up here until last Thursday, I don't have written remarks, but, with your permission, I will file some as soon as I can get them written.

As I said at the beginning, this is a timely effort on your part to look at what is working and what is not working in wholesale markets, be they organized or bilateral markets.

I would say at the outset, we ought to start at kind of the basics and understand that wholesale market structures are a means to an end, and that end is to provide benefit to end-use consumers, the end-use retail customers.

You at FERC and we at the states, really ultimately serve the same constituents. EPAct, with the passage of EPAct a year or year and a half ago, Congress answered some of the questions about market structure.

We are going to have the same structure that we have had for some period of time. There is support in EPAct found for open access. There are no mandatory RTOs and there is no mandatory retail unbundling.

You recognized that in your recent Order 890. That is the law of the land, and so that's the simple part of today's discussion.

The challenge is in the details of making this system that we've been given, work.

I am proud of and believe that we are working with you, heading down the right path with the number of collaborative efforts that we have undertaken in the last several months.

There is the competitive procurement collaborative process with Commissioner Spitzer; demand response that Commissioner Wellinghoff is leading; market monitoring, I understand that there's a program to invite state staffs to participate and visit the Market Monitoring Office, and then also regional planning, which we have been working on and which you have adopted in Order 890.

This seems to be the model that needs to work. There are areas that are clearly within your jurisdiction, areas that are clearly within our jurisdiction, but the truth of the matter is, few of these areas are purely black and white, so this kind of collaborative effort leading to real policy, not just having meetings -- we all get invited to enough meetings, but, hopefully, to come forward with policy approaches that can be implemented by whatever jurisdiction they fall in, seems to be the proper course forward for us.

I also want to say that the states, regardless of what type of wholesale market we're participating in, the states face a lot of challenges.

There is a new emphasis, not just in Washington, but at the state level, in environmental issues.

There are challenges to meeting base load demands, demands for new base load. And all state commissioners are supportive of the wholesale market as a tool to answering some of these, addressing some of these problems that we're challenged in in our day-to-day jobs that we've been given at the state level.

I said this last time I was here during the OATT reform testimony, and I want to say it again: Let there be no mistake, NARUC, as an organization, all 50 states and several other affiliates, are supportive of open access, nondiscriminatory wholesale market structures.

We are protective of the jurisdiction that we believe is properly ours, but there is no question of our support for functioning, competitive, wholesale markets.

In the comments that I will file, I'm trying to do -- I guess I should say, too, that I'm trying to speak to some at the NARUC level and to some at the bilateral markets, and I want to try to move quickly there.

But at the NARUC level, there are at least three, I think, important issues that I've been asked to raise with you, and I will simply try to go through them quickly:

Number one is the importance of regional planning and coordination. I've heard a lot about that during the parts of this morning's discussions that I was able to be here for.

We were supportive of your efforts in the NOPR, and we are supportive of where you came out in the final rule in 890. I mean, the good news here, is that this seems to be an important piece of the puzzle, and you have already moved ahead on this, prior to having these conferences, and we are supportive of where you came out on that.

The role of renewable resources: NARUC supports looking at both supply- and load-side options, as, again, we mention the demand-response collaborative, answering some of the questions that were raised this morning.

But that is important, and we believe that that is an important part of the job we are going to be asked to do, and believe that this is an area that the federal and state regulators need to coordinate on.

Then there is market monitoring and enforcement; effective, independent monitoring of markets, as much access to information as can reasonably be provided, and while being sensitive to protecting commercially-sensitive information is important, certainly as much transparency and as much access to basic market information as is possible, we believe is important to well-functioning markets, be they bilateral or wholesale. Then, obviously, there is effective enforcement.

Let me try to speak briefly to the bilateral markets, which was the real reason I was asked to be here. Let me just say that, overall, I think things appear to be going well.

I would refer you to some specific comments. I think Mr. Nipper's comments on this panel and the testimony that he has provided to you or will provide to you today, seem to answer, from APPA's perspective, support for how things are going in bilateral markets.

MS. PAUL: One minute.

MR. KERR: The North Carolina Transportation Collaborative filed reply comments in the Order 890 docket. I would direct you to them, and I will attach them to what I ultimately file, but that is, I think -- all of the load-serving entities in North Carolina seem to be supportive of the effectiveness of bilateral markets in meeting their needs.

Also, the Idaho PUC filed comments in the study, in the competition study that you undertook last year. What I would ask you to do, is to step back and see the forest for the trees a little bit.

What we are hearing from the load that is being served in bilateral markets, and particularly in the Southeast, is that these markets are not perfect. I don't want to overstate it and be naive or imply that there's not work to be done.

But the load seems to be satisfied with the functioning of those markets, and I think that's important, because that's my job, that's your job, is to make sure that the end-use customers are being served by whatever market structure, and so I have -- you know, we have investigated informally, we've looked, we've read, we've looked at people's testimony in various dockets, and the messages seems to be that, all in all, things seem to be pretty good.

I'm not naive. I suspect my friend, Mr. Shelk will have some suggestions for how things could be better, and I would also say that I think state regulators in bilateral markets, are committed to working on those things like improved planning, improved approaches to demand response, where we can make them incrementally better.

But the bottom line is, if this is the control experiment, as we go towards organized markets, if, in fact, the traditional bilateral type market is the controlled experiment, I think what you call can take, as you undertake this broad effort to think about wholesale competition, is that the controlled experiment does seem to be functioning well.

Again, I don't mean to overstate it and be naive and say everything's perfect, but I do think that if the test is load being served and how satisfied they are, I think that the verdict is pretty solid.

I would also say one more thing. I have a concern that it can be perceived, I have a concern that it could be a fact that in bilateral markets in the Southeast, wholesale markets are simply a place for incumbent utilities to sell excess.

So I have pulled the various IRPs of all of the load in North Carolina and I will do a better job of pulling this together for you in writing, but I was very surprised. There is a great deal of variety of the generators that are actually selling both short-term opportunity sales, but also longer-term contracts for intermediate and peaking capacity and energy into North Carolina.

It is Calpine; it is Dynegy; it is AEP; it is Southern Company; it is South Carolina Gas and Electric. I mean, there is -- those market -- load is being served in the state, out of the wholesale market at a surprisingly varied number of contracts.

Morgan Stanley has an agreement with four of the cooperatives in the state, so, again, trying to look at the facts, we do believe that the markets are functioning fairly well.

There are some areas that I would suggest we ought to continue to work on. I think, for brevity's sake, I will say that the questions that you have asked, I think, are the right questions. Competitive procurement, impacts on rate base, those are risks associated with rate base generation.

I mean, there are -- you have spotted the issues.

I have nothing new to offer you in terms of what the issues are, and I will wait for questions to discuss the more discrete questions that you've raised, for the sake of time. Thank you.

CHAIRMAN KELLIHER: Thank you very much, President Kerr. Let me now turn to John Shelk, the President and Chief Executive Officer of the Electric Power Supply Association. John?

MR. SHELK: Thank you, Mr. Chairman and Commissioners, for the opportunity to testify at what we believe is a critical time for the future of wholesale competition and the retail customers it serves.

The generation of electricity is not a natural monopoly that justifies exclusive franchises, accompanied by traditional rate regulation.

Wholesale competition, as others have said today, is the law of the land; it is settled policy, and it is the right policy for consumers, the economy, and the environment.

However, robust wholesale competition is not fully the reality in what we are calling bilateral markets today. Competitive suppliers have invested tens of billions of dollars in these markets, as Congress intended, but wholesale competition cannot exist without access to consumers and the transmission to reach them.

These challenges must be addressed to make them yesterday's news, not today's imperatives, and we appreciate this conference doing so.

Today's challenges are, in many ways, yesterday's, and this Commission put its finger on the source in Order 890, earlier this month. You stated then -- and this happened ten years ago in Order 888, that, quote, "It is in the economic self-interest of transmission monopolists, particularly those with high-cost generation assets, to deny transmission or to offer transmission on the basis that is inferior to that which they provide themselves.

We commend this Commission for issuing Order 890, which we believe is an important milestone that has the significant potential to substantially improve transmission access in bilateral markets.

As you have acknowledged, many of the provisions require subsequent action to fully implement them, and we believe that your oversight and enforcement will be required, if functional unbundling, as is assumed in the Order, is to be the ultimate solution, instead of structural reform.

We're also heartened by the provisions in the Order on regional planning, and I want to commend Commissioner Kerr and his colleagues in the Southeast for the work they've done on regional planning there, because, as the Order acknowledges, electricity does flow on a regional basis, and all resources should be taken into account.

Now, with transmission access and regional planning largely being addressed under your watchful eye, we believe that the most pressing challenges for this panel, are two sides of the same coin on the issues listed for us to discuss, and they are competitive procurement and the risks to consumers of rate-based investments.

In that connection, we join Commissioner Kerr in saluting the resumption of the joint federal-state dialogue on that subject.

Everyone has spoken today of the magnitude of new generation that will be necessary, and it's well documented. In fact, the Energy Information Administration says the areas with the greatest growth, will be the areas we're calling bilateral markets today -- the Southeast and the West.

But the critical point that is only now emerging, are the enormous costs and risks associated with these investments, facts that are only now coming to light as some are attempting to revert back to the days of rate-based investments.

Cambridge Energy Research Associates recently estimated that $275 billion will need to be spent in the next 15 years on power generation. Recently, both Standard and Poor's and the New York Times talked to the fact that projected costs for new power plants have risen as much as 50 percent, just in recent months.

So the policy questions really revolve around who will build and operate these plants. That will determine how risks and rewards are allocated.

From our perspective, the question is rather simple: Which structure best serves consumers? Is it the market-based approach successfully employed in the buildout of the 1990s, in which almost all new generation was built by competitive suppliers to deploy more efficient, innovative technologies at their risk, or going back to the model when overruns were paid for by ratepayers?

Despite its demonstrated shortcomings that were discussed several times earlier today, unfortunately, there are those clambering to make more rate-based investments.

We urge policymakers, as stewards for consumers, to resist these calls.

Just last week at the NARUC meeting here in Washington, Dominion's CEO asked for higher rates of return, recovery of investment, as work is done, rather than waiting until the project is completed, and advance approvals.

This would turn the traditional link between risk and reward, upside down. Rewards would actually rise as risks are lowered.

The full implication of this proposal is evident from an interview with the company's CFO in yesterday's Wall Street Journal, in which he said that a utility should not only obtain from ratepayers, a return of capital spent on a failed project, but actually earn a profit on the failed project, as well.

Now, others speak of this as regulatory certainty, which, in this context, means the regulator is being asked to shield the utility and its shareholders from the costs and risks of power projects.

Now, those who seek this certainty for themselves, know full well that it can only come at the expense of consumers, when it is impossible to provide the certainty they seek in any other manner.

In the Energy Administration's annual outlook for 2007, the new generation that will be necessary between now and 2030, could be, quote, "Only 191 gigawatts in a low economic growth case, to almost 400 gigawatts, or double that amount, in a high economic growth case," so a swing of a hundred percent.

Aside from the amount of new generation being difficult to predict today, the EIA report shows that the mix of fuels and technologies is highly sensitive to multiple variables. If investment decisions made in rate base would be made starting now, it may beg the question of who should bear those risks.

We believe, again, that the answer is quite clear: The answer here should be identical to the answer everywhere else in the private and public sectors, and that, simply stated, is competition.

Every state that we're familiar with, has a law that says very simply that if a good or service is procured for taxpayers by the state government, over a nominal figure, it must be competitively procured.

However, even in those states in bilateral markets, the few have competitive procurement rules, utilities seek ways to escape them.

For example, to its credit, the Georgia Commission has had good competitive procurement rules on the books for several years, rules that were touted by the attorney for Georgia Power at a NARUC panel just this past November, but last month, Georgia Power filed a request to exempt new base coal and nuclear plants from the competitive procurement rules.

One is compelled to ask the question, why are some afraid of competitive procurement? If their plan for meeting the needs of their customers is the best plan, they should prevail.

If, on the other hand, opposition to competitive procurement is a club against unaffiliated generators seeking nothing more than the opportunity to propose a less costly alternative, then there must be a remedy.

Absent such a remedy, wholesale competition in bilateral markets, becomes a mirage, and, again, we look forward to the joint panel that will hopefully discuss these issues.

This Commission also will have an opportunity to send a signal when it acts on Standards of Conduct, by clearly defining, in a pro-competitive manner, what types of integrated resource planning and competitive procurement qualify for any relaxed standards.

MS. PAUL: One minute.

MR. SHELK: Thank you. Today's conference consisted of separate panels on organized and bilateral markets, and our members, in fact, operate in both. But as you know, that separation is not cut and dried.

Power flows between organized and bilateral markets and we commend the Commission for the upcoming seams conference and continue to believe that further steps to improve transparency and dispatch procedures, are warranted.

Finally, transactions in all markets are grounded in commercial contracts and in their certainty, as Professor Hogan spoke to earlier.

This enables markets to achieve the lowest possible price for consumers, without the need for sellers to add risk premiums, due to the fact that contracts may be modified.

We're keenly interested in how regulators and the courts view the certainty of contracts, as the investments need to power the future, depend on it.

In conclusion, we believe that robust wholesale competition will deliver the greatest value to consumers everywhere, while protecting the environment by facilitating the right mix of long-term investment, and we look forward to working with you to make that happen. Thank you.

CHAIRMAN KELLIHER: Thank you, John, and that was perfect timing, actually. I'd like to now recognize Jeff Sterba, the Chairman, President and Chief Executive Officer of PNM Resources. Thanks, Jeff.

MR. STERBA: Thank you, Mr. Chairman and Commissioners. It's good to see you, and thanks for the opportunity to visit with you today.

Unfortunately, I wasn't able to be here for your first two panels, but I was briefed as only David Owens can do a briefing.

(Laughter.)

MR. STERBA: And it made me feel like I would rather have been here than up on the Hill.

(Laughter.)

MR. STERBA: Our industry faces multiple significant challenges, and we need to count on your leadership to ensure robust electricity and gas markets that are overseen by a consistent and logical federal regulatory regime.

By way of background, my company is in a bit of a unique position, in that we serve both competitive retail and wholesale markets, as well as traditional vertically-integrated, regulated retail markets.

In Texas, we are the fourth largest retail provider in the state. We also provide regulated delivery service.

In New Mexico, we're a vertically-integrated, regulated retail provider, and we have competitive assets that are used to serve wholesale customers throughout the West, particularly focused in California, Arizona, and New Mexico, so we not only operate in both regulated and competitive markets, but we also operate in more -- I don't like the term, "organized," but I'll used it -- organized markets and bilateral markets.

Operating in these various markets has convinced me of the efficacy of competitive markets. It's caused our company to develop a discipline on cost efficiency and productivity, and a responsiveness to customers that we did not fully demonstrate previously.

This was not just for the benefit of our competitive customers, but it has permeated our regulatory business and assets, and I believe is the key reason why since 1994, we have had four rate reductions with no rate increases, while operating without a fuel adjustment clause.

Simply put, I believe in the value of effective competitive markets. That said, I do not believe that bilateral markets and regulated markets, cannot coexist with organized competitive markets.

I believe the biggest challenges we face in strengthening these markets, include three items that I will focus on: First, regulatory uncertainty.

What's important, is to have clear and fair rules by which market operations will be guided and disciplined. In this regard, I laud the Commission for its OATT Order that clearly lays out how the important issue of transmission access will be regulated to provide transparency and efficiency.

Similarly, I strongly support most of the principles on transmission pricing that have been enunciated, particularly the treatment of project development risks and cost recovery, and, no, I don't expect a return on cancelled projects, but I do need a return of the investment in cancelled transmission projects.

I have the painful memory of eight-digit writeoffs of transmission projects that had survived numerous legal appeals and received all approvals, except for one, so I am much more cautious on new transmission projects, until such time as I see that policy fully implemented.

The NOPR on Standards of Conduct represents the kind of thoughtful approach that we need on these difficult issues, particularly where we have state and federal jurisdictions that have to coexist.

We all recognize that most of the country is in a hybrid market regime with competitive wholesale markets and regulated retail markets, which can create a tricky mine field.

The proper approach to address state IRPs' concerns, is on point, necessary, and appreciated. Its application to wholesale loads of the regulated utility, though, must be approached carefully.

In my opinion, unless a wholesale customer has specifically delegated the supply planning function to the providing utility through contractual terms, it represents a load distinct from the obligation to serve retail load and should not be covered by the IRP carve-out.

As we look forward, the biggest areas of regulatory uncertainty, are around the public policy issues of greenhouse gas regulation, the degree of mandatory renewable requirements and cost recovery of rate-based investments.

On renewables, I believe one of the most important things that can be done to advance renewable generation, is to ensure that there is a fungible and robust market for both the power and the RECs that does not know state boundaries.

The notion that a resource is only a renewable for a state RPS, if it is located in that state, is to doom the renewable energy industry to always being a stepchild of government handouts, rather than being the vibrant, market-based industry that it can and should be.

To the extent that this is successful, we will see 20 to 30 percent of generation in certain parts of the grid, being intermittent renewables, which will challenge the technology used for grid management. So, efforts like the Commission's approval of conditional firm service, is recommended and an important aspect of continuing to encourage the development of renewables.

I also believe that FERC can take a lead role in the process relative to RECs, by working to create markets under which renewable energy credits can be traded openly, without state borders, to increase siting flexibility, and it would acknowledge that energy markets are increasingly regional in scope.

The second item I'd like to address, is strained infrastructure. We face a time when both the technology of our T&D and communications infrastructure needs to be upgraded, and the quantity of that infrastructure must be expanded, but where the economics of this expansion may not always be clearcut in the eyes of the regulator, or that other issues like citing or environment, cloud the justification.

With the growing focus on intermittent renewable resources, the justification for expensive transmission expansion becomes more complex.

In some instances, the policy of incremental pricing can make it too -- no, it's not incremental pricing; it's the policy of participant funding -- can make it too expensive on a developer, yet rolling it into transmission rates, can be difficult to justify to other transmission customers, and, more particularly, to retail customers, over which this Commission does not have jurisdiction.

The tools in your toolbox are not as broad as I, for one, would like, because, for me, 75 percent of my transmission rate base, is subject to a different set of rules, that of the states.

Third, I want to touch on the need for state, regional, and federal coordination. Both of the items that

I've talked about, raise the issue of the need to encourage more communications between states and the Commission. The outreach you have conducted, has healed some of the wounds that had been created previously, and can bear fruit --

MS. PAUL: One minute.

MR. STERBA: -- thank you -- as states continue to see the value of robust wholesale markets with sound access rules and incentives for infrastructure expansion.

I believe that different kinds of market structures can coexist, so long as seams issues are addressed, and fundamental mandatory reliability standards are enforced.

While market structures may migrate over time to a more or less consistent structure, this migration process must be permitted to take place at the pace appropriate for the regulatory circumstances.

In the Southwest, for example, West Connect, which now covers 13 utilities in eight states, has plotted a logical step-wise path that has developed strong state support.

Unlike most other areas in the country, much of the critical transmission in this region, is not owned by jurisdictional utilities, so we must maintain the engagement of both these owners and our state commissions as we methodically examine the costs and benefits of different steps that can be taken to improve the efficient functioning of the transmission system in the market.

West Connect has implemented a common OASIS site for transmission information and reservations that has been widely hailed as a working alternative for a bilateral market.

It has implemented an open participatory stakeholder process to disclose TTC and ATC calculations and logic. It is also serving as a focal point for coordination of regional planning, and it's developing a pricing experiment for short-term transactions, that will eliminate pancaked rates for transactions across multiple systems, while studying the ability to create a virtual control area that is intended to capture the benefits of a single control area and accommodate higher penetration levels of intermittent resources.

In closing, we believe properly structured competitive wholesale markets benefit both competitive and regulated retail utilities, and that this Commission must continue to approach its oversight of the wholesale market with its focus on mandatory reliability, fair and open access, market transparency, regulatory certainty, and relentlessly managing the regulatory seams in the hybrid regulatory model we live in. Thank you.

CHAIRMAN KELLIHER: Thank you very much. I'd like to now recognize Jan Schori, the General Manager of the Sacramento Municipal Utility District. Jan?

MS. SCHORI: Yes, thank you, Commissioners. Good afternoon, everyone. It's a great pleasure to be here. I'm here today speaking on behalf of the Large Public Power Council, and we appreciate the opportunity to participate.

As I think the Commission knows, LPPC represents 25 of the largest municipally-owned systems in the country, and together we own about 90 percent of the transmission that is owned by the public sector, exclusive of federal transmission.

We're all members of APPA, and you'll be hearing from Joe Nipper shortly, and we support the comments that he is making in this presentation today.

We do have members that are inside RTOs, we have members that neighbor RTOs, and we have members that are solely within bilateral markets, so we do have a lot of different perspectives represented within our group.

We are all, however, load-serving entities; we are focused on delivering reliable power at affordable rates, and we do view the market from the perspective of our consumers.

The purpose of this afternoon's panel, obviously, is to address non-RTO bilateral markets, but you've just finished considering the OATT tariff and issued Order 890, and from LPPC's perspective, we think that you have gotten things right, particularly with respect to ATC calculations and system planning and we support the decision. You've directed meaningful improvement to the open access approach while avoiding experimental mandates that might cause a lot of uncertainty and price volatility. And that's something we would like to avoid, if possible.

So what's next as we look at non-RTO bilateral markets? Today I would like to talk briefly about three points. First I would like to address the importance of regional choice regarding the nature of the marketplace that best will serve consumers. Secondly, I'd like to give you a very quick overview of the bilateral marketplace in which we operate. And third, I would like to make a few recommendations on what the Commission might be able to do to promote certainty and stability in bilateral markets.

First, a general observation: Bilateral markets are the result of regional choice. There are at least two world views of the electric industry held by those who endorse organized markets and those who find that non-RTO bilateral markets are meeting their needs. The decision in the Energy Policy Act and your recent Order 890 is that we're not going to force parties to pick one or the other model. So I think our goal now should be focused on how to make these markets work smoothly for the benefit of consumers.

Second, it would be at least SMUD's assessment that bilateral markets are working and work pretty well. In the west -- obviously that's the market I'm the most familiar with -- we've made good progress with new tools promoting transparency and broad trading opportunities to maximize competition all under the aegis of the Western Systems Power Pool framework but without a centrally administered apparatus.

In my written comments I've talked a little bit about ICE, which is the trading platform for day-ahead power in the west. And Jeff has already talked a little bit about WesTrans, or OASIS site. I thought I'd mention, though, that we do have more than 300 entities participating at this point in the ICE platform. 161,000 trades were completed on that platform last year in the west. And it is growing. And with respect to WesTrans we now have 26 transmission providers on that website making surplus transmission available from Canada to Mexico at fixed prices that are known upfront by the buyers. And I'm pleased that BPA is very close to joining. And the California ISO has installed a link on their website to allow us to go back and forth.

Addressing your request for comment on the question of whether or not rate based generation and transmission investments pose a risk to consumers, I would have to say the answer is no because I think that consumers benefit from having this as an option in their toolbox.

The idea that you can have as one path the potential of cost-based ratemaking, potentially amortizing what usually is a very long term investment -- a power plant usually is going to be there 20, 30, 50 years; transmission, the same. And if you amortize it over a longer period sometimes that can then cause the rates to be charged appropriately to customers who continue to receive the benefit. And especially I think that's the case when we're dealing with well established generation technologies where there is not a lot of risk to the consumer. I think it's important to have that as a tool to be able to benchmark offerings that are coming in from the market to make sure that the prices are affordable and that the units will be reliable to serve consumers.

Third, I'd like to talk about a few areas in which the Commission can help foster certainty and stability in bilateral markets. We think that these are important aspects of high quality utility service and are particularly important to those of us that are load-serving entities with the obligation to serve.

Uncertainty regarding the expensive transmission power across RTO or ISO systems, including volatile congestion and marginal loss charges, does seem to be the principle challenge that is confronting most, if not all, organized markets. And this uncertainty remains a significant concern to LPPC members who are doing business in these markets. It's a particular concern of mine as I try and figure how I am going to be able to acquire and deliver renewable resources to my load that are remote from the system that I run.

You've asked what can be done to improve the integration of remote resources that we would like to procure on the competitive market. I'd like to mention three issues:

First, changing market rules in organized markets can have an adverse impact on ordering non-RTO utilities operating in a bilateral market.

It's been our experience that such entities have been established and modified without sufficient coordination with adjacent systems to ensure that inconsistent operating protocols do not harm reliability and commercial trade. We faced a variety of scheduling timelines, operating protocols, wholly inconsistent with neighboring control areas, and it produced challenges both in terms of computer systems and, to be frank, training of my operating staff to figure out how to make this all work.

We have learned a valuable lesson. And I would commend to you your vast experience in the hydro relicensing arena, which I've also been dealing with in recent days. The Commission in hydro relicensing takes a very aggressive approach to support meaningful prefiling coordination, encouraging the filer to go get as much input from any stakeholder that might be impacted -- agencies, participants, beneficiaries of the projects. I would like to encourage you today to consider that and potentially bring that over to talk about maybe utilizing some of those processes to help resolve so-called seams issues up front and maybe take a little bit of the burden off the Commission as we all run in and file interventions every time a new tariff is filed.

MS. PAUL: One minute.

MS. SCHORI: Second, where remote resources must be engaged through bilateral agreements that require transmission across RTO regions, we would like you to continue your efforts to help us secure firm certain prices and long-term rights for that transmission.

My final point today relates to highest price bid markets and their influence on bilateral markets. We've heard a lot today about natural gas-fired generation. I think we all agree that's now the marginal unit of supply in virtually all markets in the country. The point I wanted to make is that bid-based markets, which generally speaking are ending up paying at that last increment of power, which is gas price, is now in my view, at least, influencing pricing in bilateral markets even for long-term deals.

We at SMUD have really struggled. We go out to bid routinely to try and acquire resources, especially renewable ones, and you would be amazed at the number of bids that come back as natural gas price index plus a renewable adder. So I just would like to request that the Commission give some thought to where -- how that may be impacting pricing and whether or not we get the best deal for consumers when the prices do seem to come in so much higher than cost-based -- especially if you're dealing with, to be frank, a free-fuel resource like wind.

So to conclude, what would I put on my to-do list? I would call for RTOs and ISOs to meet with their neighbors when proposing market design changes that potentially are going to affect those neighbors. And then ask the RTOs and ISOs, if they don't accept the recommendations, to file something and explain why they are rejecting the proposals that have been made.

Second, I would look for ways to expand your efforts to stabilize transmission pricing through RTOs and ISOs.

And finally, I would ask that you take a serious look at the impact that high price bid markets are having on the bilateral marketplace and consumer prices.

Thank you.

CHAIRMAN KELLIHER: Thank you very much.

I would like to now recognize David Ratcliffe, the Chairman, President, and Chief Executive Officer of Southern Company.

Thank you.

MR. RATCLIFFE: Thank you, Mr. Chairman. And, like my colleagues, I appreciate the opportunity to appear before you and the other Commissioners today.

I have brought a written statement with me so I'll provide that for the record and try to keep my remarks brief this afternoon.

Southern Company is the owner of four operating electric utility companies, including Georgia Power, Alabama Power, Mississippi Power, and Gulf Power in Florida. In our southeastern region we have more than 41,000 megawatts of generating capacity serving 4.3 million retail customers at rates that are significantly below the national average.

We also own a fifth operating company: Southern Power, which is a competitive generation company that owns or controls 5400 megawatts of generating capacity in the southeast serving wholesale customers primarily under long-term contracts. Through both our franchised operating companies and Southern Power, Southern Company is the largest wholesale power provider in the southeast.

I first want to make it absolutely clear that Southern Company has and continues to fully support wholesale competition. The objective of wholesale competition should be to lower the cost of reliably providing power to retail and wholesale customers. This is our goal.

When we are able to buy power cheaper than we can generate it ourselves we will buy it and our retail customers benefit. And similarly, when we make sales to displace the higher cost of generation of others, the benefits of those sales result in lower rates to our own customers.

We do, however, believe firmly that there is more than one model to establish wholesale competitive markets and not all models will produce the same results when applied to differing circumstances.

As a nation we're still learning what works and what doesn't work. At least until there is clear evidence that a single model consistently provides the most consumer benefits and that other models are incapable of providing the commensurate benefits, we believe the Commission should continue to allow regions to adopt industry structures that are best suited for their particular circumstances and retain the most benefits for their consumers.

We believe the vertically integrated business model, along with bilateral wholesale contracts, support wholesale competition and ensure that its benefits are realized by retail and wholesale customers.

I'm not here to suggest that the Commission can or should try to undo organized markets or require vertical reintegration or return to cost-based wholesale rate regulation. However, we do believe that the traditional model provides numerous benefits, including reasonable and stable prices, assurance of an adequate supply from diverse fuel sources, the ability to plan the system in an integrated fashion, ensuring the lowest overall cost of investment decisions, economies of scope through operating an integrated system, and clear lines of accountability.

Southern Company's traditional model has been very successful in keeping rates low and stable. Our retail rates are based on our actual cost and not on the vagaries of the hourly spot market.

A good part of the success of the vertically integrated bilateral model of wholesale competition is that it relies by and large on long term bilateral contracts, an option that has generally not been available in organized markets. The traditional model also serves Southern Company and other utilities in the southeast quite well in terms of supply adequacy.

Southern Company has invested $5.9 billion in generation over the last five years and will invest an additional 8.6 billion over the next three years. Georgia Power Company has just filed an integrated resource plan with the Georgia Public Service Commission that proposes the possible construction of our first nuclear unit since the early 1990s, which will be a multi-billion dollar proposition.

In addition, the southeast region is flush with both utility and competitive generating assets. In fact, more generation -- 37,500 megawatts -- more utility generation, rather -- 37,500 megawatts -- and competitive generation -- 23,500 megawatts -- has been built in the southeast region. That is, the Southeast Electric Reliability Council, or SERC, since 1998 than in any other reliability council, including those covering organized markets.

The southern sub-region of SERC alone has 14,300 megawatts of non-affiliated competitive generation. And according to FERC's own statistics, SERC is the only reliability region in the country to have increased its reserve margins over the past three years.

These facts demonstrate that the vertically integrated model is working quite well to ensure that there is sufficient generation to meet customer needs. However, these same projections ought to raise major concerns with respect to generation adequacy in other regions, including the organized markets. Is sufficient generation getting built in those regions to meet future reliability requirements; and if not, why not?

In the southeast region in general and in the Southern Company in particular we've also continued to make significant new transmission investments. Over the last ten yeas Southern Company has invested $3.4 billion in transmission infrastructure. During the period 2001 to 2005 SERC's net addition of transmission circuit miles was greater than the net additions of the Northeast Power Coordinating Council, Reliability First Corporation, and the Midwest Reliability Organization, and the reliability councils that cover New York, New England, PJM, and the Midwest ISOs combined.

Southern Company will spend an additional $1.8 billion on new transmission facilities in the next five years. And SERC has over 1800 gigawatt miles of transmission currently being planned, which is more than any of the organized markets and more than any other reliability council except Western Electric Coordinating Council, which covers a significantly larger area.

Integrated resource planning with the traditional vertically integrated model has also contributed to the success of our demand-side management programs. For example, Georgia Power has the largest real-time pricing program in the country with over 2100 customers that are participating. Georgia Power estimates that the current price patterns -- under the current price patterns the RTP program saves over 350 megawatts of capacity due to customer response.

MS. PAUL: One minute.

MR. RATCLIFFE: The Commission's own 2006 assessment of demand and response and advanced metering recognized Georgia Power as having the most successful voluntary RTP program in the country.

Southern's estimated total capacity savings resulting from both demand response and efficiency programs is about 2800 megawatts. Across our four franchise operating companies we have over 50 demand side and efficiency programs in place, and we have an additional 25 programs awaiting regulatory approvals.

Perhaps most importantly, our customers are satisfied with the results of the vertically integrated bilateral wholesale market business model. Southern Company has continued to receive the highest rankings in customer satisfaction from its retail customers.

In addition to our success in serving retail customers we participate actively in bilateral wholesale markets in the southeast. We understand that there have been complaints from independent power producers that the vertically integrated utilities do not provide opportunities for competition. But at least in Southern Company's case the evidence is clear that the competitive wholesale markets are robust and active.

In 2006, for example, Southern Company purchased over four million megawatt hours of power from third parties worth $230 million to replace higher cost energy that we would have otherwise had to generate ourselves. Our estimated cost savings from these purchases was $23.5 million in 2006.

It's also important to note that in 2006 we purchased over 1.1 million megawatt hours from independent power producers for about $102 million, amounting to 28 percent of our total purchases.

With respect to longer-term purchases to meet native load requirements over the period from 1998 to 2006, the retail operating companies of Southern conducted nine long-term capacity solicitations in which respondents submitted over 200 proposals, offering over 160,000 megawatts of power. Contracts for 7500 megawatts of capacity were entered into and Georgia Power is currently negotiating contracts for an additional 2100 megawatts of needed capacity.

Almost 30 percent of Georgia Power's generating capacity is supplied from wholesale contracts. The ability of our operating companies to enter into long-term contracts for power supply has been a major contributor to our ability to assure supply adequacy, reliability, and stable cost.

While we applaud your efforts and the progress made in the Oak Reform rulemaking, there were at least three proposals to FERC to mandate industry structure in areas not currently covered by organized markets. In the written comments we filed in response to that proceeding we detailed our concerns with all of these proposals. But now it suffices to say that Southern Company is strongly opposed to any proposal that would mandate structural changes in our region.

While the Commission should not impose any particular industry structure or business model nationwide, we do think there are some actions it might consider to improve the operation of bilateral competitive wholesale markets. For the most part you're already addressing these issues and we commend your diligence and foresight in doing so.

In the interest of time I'll not cover our recommended actions, but they are discussed in our written testimony.

In conclusion, we wish to commend the Commission for initiating the current set of conferences on competition in wholesale markets. I believe it's time to take a step back and see what is and what is not working, working in both LMP and traditional competitive wholesale markets. It is clear that there is a growing belief that organized markets have some issues that need to be addressed, and there are elements of traditional markets that can be improved as well.

We urge the Commission to adhere to basic principles it should apply to all competitive markets as they undertake to examine these markets. In the southeast we believe competitive wholesale markets are working quiet well, to the benefit of our retail and wholesale customers.

While certain incremental Commission actions will help to further improve these markets, we do not see a need for major changes. We have demonstrated a record of building new infrastructure to meet the needs of retail and wholesale customers, and transmission users in our service areas. And with oversight by FERC and our state commissions we think the wholesale markets are working well.

There's no evidence that implementing LMP markets or some hybrid of regulated and LMP markets as has been proposed would be beneficial to customers in our region. The current traditional structure of utilities in the southeast has served consumers well. We believe it can and will continue to do so in the future.

Thank you.

CHAIRMAN KELLIHER: Thank you very much. We appreciate it.

And I'd like to recognize Joe Nipper, the Senior Vice President of the American Public Power Association.

MR. NIPPER: Thank you, Mr. Chairman. Good afternoon to you and the Commission. I appreciate the opportunity to be here. And we want to thank you as well for holding this conference today on wholesale markets and look forward to the next conferences you're going to hold.

APPA is the national service organizations representing the interests of the more than 2000 state and locally owned electric utilities around the nation. Collectively these public power systems serve over 44 million Americans.

Consistent with our members' business model, as community-owned not-for-profit electric utilities, APPA has a long record of support for consumer protections. This includes support for federal legislation and policies to establish effective wholesale competition in electricity as a means of providing additional benefits to consumers and ensuring just and reasonable rates.

For example, APPA strongly supported provisions in the Energy Policy Act of 2005 to promote wholesale market competition, including the broad ban on market manipulation, service obligation protection for load-serving entities, the requirement for long-term transmission rights, enhanced Commission authority to review mergers, and meaningful penalties for violations of the Federal Power Act.

The Commission and the Staff have done a great job of implementing the Act's numerous requirements and doing so on time. We want to particularly commend you for the final order on long-term transmission rights. And we hope that the guidelines it set out in the order will be fully implemented in subsequent proceedings.

As you know, almost all of our members rely on the wholesale electricity markets for at least a portion of the power that they supply to retail customers. And many rely exclusively on wholesale purchases to serve their customers. Thus, public power systems are heavily impacted by changes in the structure and functioning of these markets.

Today's conference has covered many aspects of the wholesale markets important to public power systems. And I want to express my strong support for Mr. Thilly's comments this morning, among others.

APPA intends to file for the record a comprehensive statement expressing our views on a number of issues that have been raised today. Our filing will include the results of the first set of analyses conducted under APPA's Electric market reform initiative. We started this initiative to assess the problems our members are facing in the wholesale power markets in marteo regions. And we hope the Commission and the Staff will review those studies carefully.

I'm aware, though, that this panel has been asked to address wholesale power markets in regions that rely on bilateral contracts. And my remarks this afternoon will focus on that topic.

First, I want to support the comments made by Jan Schori and affirm that all of Public Power agrees with the concerns and the issues that she has raised. I want to particularly reiterate her point on respecting local, state and regional choices and rights in making any changes to market structure or design.

I'm not aware of a single APPA member operating in either a bilateral market or a day-one mark that has told APPA they think they'd be better off in a day-two market. So I think the situation that we have now is one that we probably, hopefully, can expect to continue with regard to the furtherance of the day-two markets.

With regard to bilateral markets, we believe that in general they're working relatively well in most regions and achieving their key consumer interest goals: providing power at reasonable prices, maintaining reliability, and facilitating investments in new generation and transmission facilities. Moreover, as indicated previously, there is a very robust level of activity, trading and investment occurring in most bilateral markets. Many public power systems are constructing new generation facilities, and some are constructing transmission facilities, to meet the accelerating demand for energy in these regions.

The two issues that have been of most concern to Public Power in recent years in the bilateral markets are lingering transmission discrimination, particularly in certain areas, and the need to improve regional transmission planning and coordination.

We appreciate the Chairman's initiative to reform the open access transmission tariff and the Commission's recent issuance of Order 890. We are still reviewing the details of the order and consulting on that with our members. However, while we may have some concerns with discrete aspects of the order, our overall initial reaction is very positive.

As a result, the outlook for increased competitive pressures in the bilateral markets to assist the

Commission in ensuring just and reasonable rates is very encouraging.

We want to again note the multiple benefits gained through joint ownership of transmission and generation facilities. It's now widely recognized that the industry is going to have to make very substantial investments in new base load generation and transmission facilities, even if we do all we can to promote and integrate demand resources and increased efficiency.

Public Power is ready to contribute capital to help construct the needed facilities, so long as those investments will support our service obligations to our customers. Thus, we urge the Commission to encourage and facilitate opportunities for joint ownership of generation and transmission facilities.

Lastly, as Ms. Schori alluded to, the newest and fastest growing concern we have in bilateral markets, frankly, are the adverse impacts caused by adjacent RTO run day-two markets. Ms. Schori discussed the problems with inadequate coordination and other issues, and we certainly agree with her concerns and support her recommendations in that regard.

Another example that she mentioned that I want to amplify on a little bit is the emerging spillover into adjacent bilateral markets and the increasing problems our members are having in those regions of securing long-term power supply contracts at reasonable prices. Owners of generation capacity who have the opportunity to earn high margins in the RTO spot markets have little interest in long-term contracts in adjacent bilateral markets that do not produce similar returns.

This generally means they want prices pegged to the anticipated future prices in RTO run spot markets which are often set by gas-fired units. The opportunity to take advantage of price volatility in the LMP based markets is an additional disincentive to suppliers to enter into long-term fixed price contracts when those generators are positioned to move power into either the RTO or the bilateral markets.

You might think that generators would want to avoid this price volatility by entering into long term contracts, as customers do, but our members are generally not seeing this.

And so, in conclusion, Mr. Chairman, members of the Commission, I want to say that the bilateral markets are working relatively well. Moreover, we believe that Order 890, if vigorously enforced, will address lingering transmission discrimination through measures such as collaborative regional transmission planning.

In addition, we urge the Commission to promote and facilitate joint ownership of generation and transmission facilities as a way to spread the financial risk associated with the next round of infrastructure additions.

And finally, we urge the Commission to work with all interested parties to explore ways to limit or eliminate the adverse impacts of the RTO-run markets on adjacent bilateral markets. And we look forward to the conference that Commissioner Kelly mentioned a few moments ago that you're planning to have later this spring in that regard.

Thank you again for allowing me to be here. I look forward to your questions.

CHAIRMAN KELLIHER: Great. Thank you, Joe. Very efficiently done.

And let me now turn to our last speaker. And I don't want -- and I want to tell him that he's actually in a prime spot. I think being the last speaker to give an organized presentation is actually an excellent spot. So don't regret your placement.

(Laughter.)

CHAIRMAN KELLIHER: Robert Bryant, the President and General Manager of Golden Spread Electric Cooperative.

Thank you.

MR. BRYANT: Thank you, Mr. Chairman.

The clean-up spot, as it were.

CHAIRMAN KELLIHER: It's good.

MR. BRYANT: Thank you, Mr. Chairman, and members of the Commission. On behalf of Golden Spread and its 16-member distribution cooperatives and the more than 200,000 retail customers and consumers that they serve, I want to thank the Commission for its continued efforts to foster retail competition and foster competition in the wholesale markets. Ultimately it's those retail consumers who are the intended beneficiaries of successful competitive markets.

I appreciate the opportunity I have to share with you my concerns about the state of the wholesale competitive markets, my views naturally are shaped by my experiences. I do not think those experiences are unique in the wholesale marketplace.

You'll note that my remarks are directed more to concerns than kudos for the progress already made. I expect that you would not have convened this conference if you did not want to hear where work remains to be done.

In any event, I trust that you will not interpret this focus as indicating a lack of appreciation for past efforts, and we continue to support developing competitive markets. I'm going to focus on obstacles for bilateral contracts for load-serving entities in the deregulated markets.

Golden Spread is a generation and transmission cooperative. We were incorporated in 1984 with eleven members serving about 88,000 retail consumers. We have a combined peak load of 550 megawatts. We became FERC-jurisdictional in 1987. We were reselling full requirements wholesale power service that we purchased from Southwestern Public Service Company.

Our members are located in both ERCOT and in the Southwest Power Pool. We serve about 200 megawatts of load in ERCOT, a little more than 1000 in the Southwest Power Pool. We're located in the Texas panhandle. The members serve extreme southwestern Kansas, the Oklahoma panhandle, the panhandle of Texas, down through the south plains nearly to the Mexican border, serving more than 24 percent of the land mass of the State of Texas.

Much of the member load is summer-peaking irrigation load. Our purpose and objective is to provide long-term reliable firm load following power supply to our members.

Since 1980 we've been actively participating in and tried to influence the development of regulatory policies affecting restructuring of the electric utility industry. But in 1995 we began the process of developing our own generation as a hedge against the risk of wholesale deregulation in the absence of truly competitive markets. Between 1999 and the summer of 2007 we will have caused the installation of about 790 megawatts of new generation within the SPS control area.

Much of our fears have proven to be correct. All of our wholesale power suppliers have served notice of termination of firm cost-based requirements service. In 2003 we accepted membership of a new member which received notice of termination of service from Southwestern Public Service. They'd been a full-requirements customer of SPS for near 70 years.

Because there was no transmission access into the SPS control area there was no other bilateral sales market for replacement long term firm load following wholesale power supply. We had to install generation to serve this new member.

Transmission improvements are not being made in our area. They're not being constructed in a timely manner, either to maintain reliability or to foster competitive markets. And transmission improvements are not being constructed in a timely manner to meet transmission distribution customer needs. We found it necessary in the eastern panhandle to install diesel generation because a transmission owner cannot provide service currently and can't do so in a timely manner.

We're facing a situation in the area north of Amarillo and up to the Kansas line where about 40 megawatts worth of load cannot be served in a timely manner. A large industrial customer wants service in about 20 months. The Southwestern Public Service has told us they cannot provide the transmission service for at least 32 months from the time frame that management provides budget authority.

We're faced with installing temporary generation to support that load.

The SPP has identified transmission expansion projects considered necessary for the southwestern Kansas, western Oklahoma, and the Texas panhandle. It's called the EX-plan. The new transmission facilities will significantly improve transmission import capability. They will allow the import of about 430 megawatts of new capacity from a 700 megawatt solid fuel plant that Golden Spread is developing with Sunflower Electric Power Cooperative. This capacity is needed to replace power supply arrangements that are being terminated.

SPS voted in a Southwest Power Pool committee against the SPP issuing notices to proceed with development activities for the EX-plan. It appears that they're taking little, if any, action to implement that plan. That's an interesting plan because it has the opportunity not only to import power but to export a significant amount of wind power. And the Southwest Power Pool has developed a second stage or second layer of plan at voltages of up to 765,000 volts that will export as much as 4500 megawatts worth of wind into the Eastern Interconnect and into the ERCOT market.

The existing transmission limitations into the SPS control area have resulted in charges in the SPP energy imbalance market that exceed $2000 a megawatt hour for certain intervals. Transmission constraints in other parts of the SPP have resulted in similarly high interval charges.

Risk of high current power costs due to transmission constraints has a chilling effect on the emergence of bilateral contracts. Sellers are risk-adverse. Contracts impose added cost and risk on the buyer. The buyer cannot effectively measure the economic risk of TLRs and imbalance charges, replacement power, and so on.

Any designation of new power supply resource creates exposure to direct transmission upgrade costs. The termination of wholesale power contracts forces wholesale customers to obtain new resources. The existing TO captures-recaptures both the generation and the associated transmission. The failure of the TOs to expand the transmission system assures needed transmission upgrades when DNRs are changed.

Some key policies that I think are needed to promote competition are first to expand the current focus on the short-term energy markets to address long term issues. Recognize that energy resource required by most electric consumers is long term firm load-following service.

MS. PAUL: One minute.

MR. BRYANT: Thank you.

Adopt policies that support market entry as a means to diminish inherent advantages of existing generators with significant market power.

Recognize that truly competitive wholesale markets must have viable bilateral contract opportunities that offer firm power or unit firm power with reasonable replacement power arrangements.

Don't permit economists' fixation on LMP to undermine long term resource planning. Very high LMPs are a sign that the horse has already left the barn.

Firm economic rights are essential to assure economic -- Firm transmission rights are essential to assure economic value of energy resources enjoyed by customers who pay the cost of those resources.

Some specific measures that will promote competition are long-term backbone transmission planning. Enforce ten to fifteen year planning horizons with assured construction backbone transmission necessary to meet loads and resources. Transmission now follows generation. Backbone transmission should lead generation. Transmission routing should be friendly to new generation resources, close to rail, water, development sites, and so on. Cost of backbone transmission upgrades should be postage-stamp priced with a specific allocation of upgrade costs. Market structure should be designed to prevent blowout pricing -- for example, $1000 a megawatt hour.

All market participants should support maintenance of a replacement reserve market on an insurance pool basis. Replacement reserves should provide replacement energy on a cost-plus basis to market participants experiencing forced outages.

In conclusion, competition at the wholesale level in the electric power industry can contribute to improved efficiency and lower cost. The nature of the industry today and for the foreseeable future is such that competition at the wholesale level for long term bilateral service is limited and must be nurtured by regulatory policies that assure adequate transmission, long term firm transmission rights, and reasonably priced replacement power.

A laissez-faire approach to regulation that contributes to price spikes and emergency reliability problems will undermine the development of competition. Encouraging market entry with the ability to supply firm load-following power will expand competition.

Thank you for the opportunity to be with you today.

CHAIRMAN KELLIHER: Thank you, Mr. Bryant. I appreciate that.

I think I'm going to refrain and defer to my colleagues. And maybe I'll try to go last. But let me turn to Commissioner Moeller.

COMMISSIONER MOELLER: Right.

CHAIRMAN KELLIHER: He's been very patient.

(Laughter.)

CHAIRMAN MOELLER: I think the chairman should get first crack, but all right.

Thanks to all of you for your comments. I guess I want to start it off, basically hear from all of you on bilateral markets. It seems to me that you can take lots of pros and cons of organized bilateral, but at least one o the pros of an organized market is you at least get to see congestion costs better and that they are less likely to be socialized and hidden and therefore, if you hide those you are less likely to be able to address the problems that are causing them.

So I guess the theme of the question is how to increase transparency in bilateral markets. And I'm going to open it up to all of you.

Commissioner Kerr, could you begin?

MR. KERR: I thought you would start at the other end.

(Laughter.)

COMMISSIONER MOELLER: I'm trying to give the president of NARUC adequate respect.

MR. KERR: Thank you. Can I defer to the other end of the table?

No, I mean I think it's -- obviously that is a concern. And I think hopefully through planning, through the planning process that is more inclusive, involves more folks who are actively participating in the market, who are seeing what is -- I guess each have a better understanding of what their own individual experiences are in that regard and then bringing that into the planning and relieving congestion and constraints is probably the best answer that I have for you.

MR. SHELIK: You put your finger on an important issue. Obviously the Commission says the market report recently issued talked about this: inherently, as you said, there's more transparency by definition than organized market. Clearly absent going to that everywhere, the initiatives in 890 were transparency was such an important principle. We made some proposals that you declined to adopt that would have gone beyond that.

But I think the idea that the more information that's out there, the more that's on OASIS, the more transparency the better, for all the reasons that you said. Otherwise things are hidden. People don't know where investments should be made and don't know why things aren't happening the way they should. So we would be glad to work on additional ideas. But certainly inherently you're going to get more transparency in an organized market.

MR. STERBA: We certainly see in our involvement in Texas that we're headed toward an LNP market and it's really to help provide better pricing that the zonal mechanism does today.

At the same time what most of those market mechanisms do is they provide information about the short run price. What's the price today and what may it be in the short run. But frankly, I'm more focused on the expansion of the system. And so what I care about is what's going to be the congestion going forward five years from now.

I don't know what the LNP will be. But I certainly have enough information to understand where the bottlenecks are; what needs to be done to alleviate those bottlenecks without necessarily knowing what the LNP will be specifically five or eight or ten or fifteen years from now.

So I think the fundamental issue of de-bottlenecking, which involves not the dispatch question but the physical expansion question, can be understood in a bilateral market through good joint planning and the sharing of information on base cases, and the development of the transmission expansion plan.

MS. SCHORI: I couldn't have said it better myself.

MR. STERBA: Oh, yes you could.

MS. SCHORI: I wrote down that your order on ATC and joint planning are critical. There is a huge difference between trying to figure out constraints in the real time market and trying to plan incorporating generation over a ten-year window for meeting renewable goals or whatever the region needs.

DOE itself has been able to publish a report, and FERC has been involved in identifying these key bottlenecks. I actually think that there's not much mystery. We actually know where most of the bottlenecks are. And I suspect most of us here are actively engaged in planning groups trying to figure out how to address those. The tough issue sometimes is identifying who benefits, who pays, what do you get for your investment, and that kind of thing.

I will say in other markets I would just be somewhat cautious. Full transparency, at least in my experience, can actually burn me. And I always have a debate with my own board members over publishing our engineering estimate to the world at large on whatever project I'm going to undertake because it's kind of magic. All the bids come in and they're always using that as the floor and they go up from there. So you want to be sure that you're not actually influencing the market with some floor price when you do that.

MR. RATCLIFFE: I agree.

MR. NIPPER: I'll shock you by agreeing with my member.

(Laughter.)

MR. STERBA: I think there's a little too much collusion there.

(Laughter.)

MR. NIPPER: I'll just say I do think that they're making great strides in that regard in Order 890 and as has been said, that the regional planning and coordination to alleviate those bottlenecks and congestion is really the key here.

MR. BRYANT: We do indeed know where the bottlenecks are, the congestion zones in our areas. And I would share in the view that we need some additional joint planning. We see ERCOT developing -- folks in ERCOT, not ERCOT itself -- but independent developers in ERCOT seeking to develop a very expensive panhandle loop to reach out of the ERCOT area up into the Southwest Power Pool zone in the panhandle and to harvest wind resources. It's a high voltage system for which there is no feeder system, no gathering system. It's going to be very difficult to interconnect wind with that and move it into the ERCOT zone.

On the other hand, there's far more wind that can be used by the load sink in the area or ERCOT or perhaps even the eastern interconnect. It is a large enough sink that can perhaps absorb all of the wind power that's available. And yet these entities are not talking well to each other. There's some communication, but not enough to joint plan and develop the necessary transmission sources to provide reliable service to the load and also to look at the opportunities to harvest the vast wind resources that exist in our region.

COMMISSIONER MOELLER: Well, I guess that's a commitment pretty much from everybody that joint planning is needed and you will take it seriously as your various roles imply.

I'm about out of time. But the issues of renewables was the next question I was going to show out, which was we heard pretty clearly from the renewable, at least the wind industry this morning, that organized markets are better for them.

And yet particularly Ms. Schori in California, you've got -- let's see -- you still have to go with the governor's requirement of a very aggressive renewable portfolio standard two or three years from now. And yet you're quite challenged as to how you can make that happen with the bilateral --

MS. SCHORI: The unique thing about renewables is that generally you have to go where the source of the fuel is, whether it's geothermal -- now there's some limits on biomass because you get into how far do you transport wastes in order to find it. We have some new dairy digesters and we're just going to stay with the cows right there with the new projects we're putting in.

But the policy drivers have been, to be frank, tax policy. There are major incentives now for investors to develop resources. You also have RPS standards in California that apply to everybody, and I think that's becoming really the standard throughout the west. Almost every state is adopting something. So we all have a stake in trying to figure out how are we going to get transmission built to serve these resources. But I will tell you there are a number of different proposals.

And I think Professor Hogan this morning talked about how do you deal with the principle. Do you just socialize the cost -- I'm using that in the sense of spreading it around, not the political sense -- of development of improvements to the grid? And it becomes somewhat challenging if you're one of the ones that will pay as part of the transmission charge but you don't have any ability to access that renewable.

And so for me my worst case scenario is I end up paying for a transmission grid to bring in renewables -- forgive me -- that help my IOU brothers. But I can't get any to Sacramento and yet I still have the 20 percent requirement that I have to develop. So it's always a knotty issue to figure out who benefits, who should pay.

Your longstanding tradition has been those who benefit should pay. And so with development of renewables we have to collaboratively work together to figure out how we're going to access these resources.

COMMISSIONER MOELLER: My time's about up.

But Jeff?

MR. STERBA: Commissioner, I heard that this point was made, and I frankly -- I want to understand from the person who had made it the basis for it because I just don't agree with it.

We have -- We procure renewable resources in both organized markets and bilateral markets. I have not found that one market by the market structure itself provided more or less of a favoritism or incentive to do it. Frankly, I agree with that Jan has said. What has driven it is tax policy, renewable portfolio standard policy within states. But of the five resources that we've -- the last five resources we've procured in New Mexico, three of them are renewable resources and two of them are demand side resources.

So I question the challenge.

Now I think when you're talking about shorter term resources and their appropriate dispatch, that -- the pricing signal that can come from LMP may give a better signal as to how they should be managed and dispatched. But in terms of the longer-term contracting that's essential for those resources to go forward, I don't -- my experience is not that one market structure is better than another.

COMMISSIONER MOELLER: Thank you all. The debate will continue.

CHAIRMAN KELLIHER: Commissioner Kelly.

COMMISSIONER KELLY: Thank you.

Joe, you have said that you're going to file the results of APPA's electric market reform initiative, the analyses that you've done. But can you summarize briefly why you understood that study and what your study concludes?

MR. NIPPER: Yes, ma'am.

We haven't come to any firm conclusions, first let me just say that. But our members are generally not seeing the benefits in the RTO markets that were touted this morning. They're generally reporting to us that they need to pay higher prices than they think are reasonable for power supply and high administrative costs for the RTO operations and that sort of thing.

COMMISSIONER KELLY: And, Joe, is that day two markets or --

MR. NIPPER: Day two markets, yes, ma'am.

And so they asked us to take a look at some of the aspects of what was going on to see if we could get some more information and try to determine with more certainty what is happening and why these problems may be occurring and to ultimately come up with some suggestions for policies that might remedy this.

We started by taking a look at the plethora of reports that have been issued -- studies that have been issued over the last year or so that tout the benefits of the RTO markets and some that don't, and wondering whether there was value to those. Professor Poken's analysis of those found that all of them are, frankly, methodologically flawed to the point where their conclusions can't be relied on. And so there really is, to date at least, no reliable evidence to show that consumers are benefiting from those markets. They may be, but there's no evidence to support that.

So given our members' concerns on that piece we started looking at some of the other aspects of that. For example, short-run marginal costs. We asked London Economics to look at that and they generally find in looking at PJM classic that short run marginal cost, the bids on short run marginal costs were actually frequently running eight to fourteen percent higher than the short run marginal costs; in some cases as high as 20 percent. So that indicates a bit of a problem to us.

We asked Synapse Economics to take a look at the locational marginal pricing mechanism, how that's functioning. And while there's clearly some benefits to LMP in terms of system operation and that sort of thing, they also found that it's not -- there's no connection between that and investments, as has been mentioned before, and that the -- and that LMP is not -- certainly by itself doesn't guarantee a competitive market and does not help against market power.

Another issue that we're concerned about, given again we're looking at the concentration of generation assets particularly in subregions at PJM and how that might affect suppliers' ability, and then, of course, relating back to the bids and all of that.

One of the -- and so these are just examples of some of the things we're looking at. We have an analysis going on right now by Ken Rose that we hope is just about finished, and may be finished in time for us to submit it as part of the record as well -- We'll certainly get it to you -- examining this question that's been raised many times today and many times over the last few months about the relationship between fuel prices and power supply prices, and the assertion that's made that the increase in fuel prices is solely attributable to increases in fuel prices.

Dr. Rose has found that that's not the case, that there are -- that fuel prices -- that the increase in power supply prices cannot be solely attributable to fuel costs. And he has a very rigorous analysis on that.

So these are just some examples, Commissioners, of things that we've begun to look at again to try to get a handle. We're trying to approach this in a very thoughtful and analytical way. I'm struck by Professor Hogan's remarks this morning, his characterization about big-R and little-R and, you know, we're really I think, you know, hopeful that we can find some little-R ways to deal with some of these things.

But taken in the aggregate the initial results of our analyses do paint a pretty troubling picture. And so we want to do more. But that's what we've been up to. That's kind of where we're headed.

COMMISSIONER KELLY: Thank you.

I know that we will -- our Staff went to your conference and got a good feel for what the studies are. And so we look forward to the filing of the full analysis.

I know that John was there at that conference. And you may have some comments.

MR. SHELK: Sure.

To the credit of APPA, they did invite a number of us to come and listen to the presentation. And I think what I took away from it, it was rather interesting that the speakers on the panels first of all said not to get rid of LNP. They also said that replacing single price auction with as-bid would not lower prices. These were the people that they had come.

And Professor Kolka -- I've been on panels with him. He's a distinguished professor. But the point that we made is that he critiqued about a dozen or fifteen studies, both pro competition and finding problems with competition. And these are some of the most accomplished economists in the country, major consulting firms that built eight billion dollar utilities and others rely on. So it causes us to say why is one man so right and a dozen or so wrong.

And the most puzzling thing is he even criticized firms that were later on the same panel at the conference. So this idea -- I don't often agree with Marilyn Showalter, but I'd have to say she asked the best question at the conference, which was, you know, the gold standard that Professor Kolka puts up. Nobody could meet the standard that he provided. So he didn't do -- Let's be clear: He didn't do the study himself based on the methodologies he said should be employed and concluded competition didn't work; he just kind of, you know, criticized like a dozen or so other people whose credentials again are rather self-evident.

But again, to Joe's credit, to Allen Richardson's credit, they did include a number of us and we did have a good dialogue. But I think it's important that -- I was surprised, pleasantly surprised that the conclusions were closer to what we would advocate than what I expected from the meeting.

COMMISSIONER KELLY: Thank you.

Jim, did you have a comment?

MR. KERR: I was not invited to Mr. Nipper's conference; I was invited to Mr. Shelk's.

(Laughter.)

MR. KERR: And so was the Chairman. And this topic came up.

And one of the comments that I wanted to make was to try to encourage the Commission and hopefully my commission and my colleagues at state regulators will not become constrained by the tyranny of price or even the tyranny of efficiency but try to look more at the qualitative issues. I mean what we are hoping for us a system that will serve the citizens over the long haul. And some of that is price. It's important. But to some extent these post-hoc studies say 'my study is better than yours and my prices are better but you didn't allow for this.'

Well, first of all, I'm biased because I can't understand most of them. But the point is, you know, what we really ought to -- we want a robust system that can do more than just seek pure economic efficiency or the lowest price. I think that some of the mistake that was made by some legislatures ten or so years ago was they got focused on price and what would lower price and not focusing on things like fuel diversity, like reliability, like price predictability, like responsiveness to some of these various public policy initiatives like renewable generation or broader carbon policy concerns.

And, you know, I was struck by Commissioner Moeller's question about transparency. I mean does one system -- does one type of wholesale market reveal transparency better than the other? I suspect one does. That's a good thing to know. But --

Which system reliefs congestion better. In other words, which system is getting transmission build. Which system is solving a problem for the society that we are all charged to serve?

And so I just would encourage us not to waste a lot of time talking about post hoc price studies or the tyranny of prices. They are important. I'm not elected, I'm appointed, but still prices are important.

But I do think we have a broader mission here and what we ought to talk about and what I hope you all would do, is focus in on the more discrete questions incorporating renewables, those sorts of things and as you are looking at wholesale markets.

MS. KELLY: I had a question about what's happening in the west, and Jeff you mentioned it when you talked about West Connect and what's been developing there. I also understand that there is the northern tier, three utilities that have gotten together to look at a virtual control area, and that there is discussion in the northwest about some coordination with Bonneville and some of the utilities up there.

Have I missed anything? Has anything else going on in the west and what's driving this? Is this a grassroots effort to look at ways to facilitate competition in the bilateral markets?

MR. STERBA: From West Connect's perspective, and this would be mostly aligning the southwest, although it is increasingly moving north.

MS. KELLY: Yeah.

MR. STERBA: There are a few other things. For example, we are looking at experiments about how can we constructively, for certainly short-term transactions, avoid the pancaking charge for multi system transactions.

But I think what's really happened is that we in the west have had to recognize that we've got to have two constituencies aligned with us. It's got to be the brothers and the sisters of the public power and investor-owned community. And it has to embrace the state regulators.

Because we're not going to get anywhere unless we have all three of those constituencies aligned. And they all have different interests and different leverage points.

But I think from that, what we try to focus on is developing a road map of change that helps ensure each of the steps we take makes economic sense, as opposed to leapfrog into something that we hope and pray will have more benefits than costs.

We are doing a stepwise process toward it and I think, you, over time, will be able to measure our progress in that regard.

I can't say that we will get to the same point of supposed organized markets at the end of the day but I do think that we will find those ways that cost effectively enhance transmission planning and organization and pricing of resources.

MS. KELLY: And will they be able to handle the delivery of renewables as well to meet the various mandates?

MS. SCHORI: Oh, I get to answer that one. I think that's a key issue and I would just add to what Jeff said, that WCC has quite a panoply right now of planning activities that are underway and all of us are working to discuss how we will achieve the overall renewable goals and where the constraints may be.

Because to be frank, those may not be the areas where you have constraints due to load issues. They tend to be in more rural areas and you need to build to get them connected and then you have this fundamental issue of what I always refer to as kind of the lumpiness of transmission investment where you have a fairly significant capital expense and you have to get enough people to belly up to the bar basically, to make that investment and particularly when you are dealing with very small generators. You do have to try and figure out how to accomplish that.

The good thing, I would say, is that since most load serving entities now in the west have this obligation, they all have the same incentive to try and identify these areas and come up with solutions that potentially would bring those resources in the market. But we still have a lot of work to do on that front, I think.

MS. KELLY: Thank you.

CHAIRMAN KELLIHER: Thank you. Colleagues? Mark.

COMMISSIONER SPITZER: Thank you Mr. Chairman. Mr. Bryant, I had the honor of regulating cooperatives in Arizona and I appreciate your approach here. It's not easy to be the bearer of bad tidings sometimes. But it's almost a demonstration case for some analysis.

You state competition at the wholesale level and electric power industry can contribute to improved efficiency and lower cost. But you further say, in response to your conundrum, unless a fair approach to regulation that contributes to price spikes and emerging reliability problems will undermine development of competition.

And we've got -- I'm as much a nationalist as anyone else, but people from Europe would look at the balkanized system that we have, which is vistisual going back to 1935 and the jurisdictional issues, particularly in the west, regulated, non regulated, state jurisdictional issues, and I'm respectful of the states rights issue, but you've got -- you fall into a gap here. And there was no one entity, such as an RTO, where you can go and say we have a generation issue.

You had no one to go to for necessary transmission, for reliability, much less economic efficiency. No one to go to for building transmission, no one in charge of demand response or renewables or some of the other issues, but the basic blocking and tackling the generation of transmission wasn't getting done. And you've graphically demonstrated that problem.

So in the absence of that one entity, how do you tackle this problem? What would be your solution if you were king of the world?

MR. BRYANT: Well, what we've done to date is to try to build generation necessary to support the loads, our loads in the area and generally support the region.

In terms of transmission, we're trying to work with the Southwest Power Pool, which has been slow perhaps, but responsive and becoming more responsive to our needs and we fit in the area of where the Southwest Power Pool is responsible for that region of the area and yet it's the most transmission constrained where we're not getting the investments needed, I think in the time frame that's required.

I guess if I were king of the area, at least, I'd try to build the necessary transmission interconnects to the southwest Power Pool that would support the reliable operation of both the investor owned utility and the electric cooperative system that exist there and work to support the development of the wind resource potential that is there. It's just tremendous. It's enormous.

COMMISSIONER SPITZER: And your area, you've got those resources. Your service territory is not one typically associated with the absence of transmission or constraints. Yet you've laid this out.

MR. BRYANT: It is associated with the absence of transmission. It operated as an island for many years long time ago. It had gushes as late as the late '80s. It had an interconnection transport capability, import capability of only 59 megawatts on a 5,000 megawatts system. It is an area with absence of transmission.

COMMISSIONER SPITZER: Mr. Nipper, I've seen great successes with joint ownership.

MR. NIPPER: Yes sir.

COMMISSIONER SPITZER: It's not the type of thing, at least in my judgment, apart from the legalities, where there ought to be coercion, but it ought to be voluntary and I'll start with you and then maybe I'd like to hear from some of the IOUs.

What can be done where you have joint advocacy, in terms of explaining -- we covered this in the other panel -- explaining to the constituency groups the economic, the reliability benefits, the economic benefits and the environmental benefits, where the entities within a region speak with one voice can be much more profound.

So what would you articulate as the carrots out there for working with IOUs, and then to the IOUs, what carrots or pitfalls are there?

MR. NIPPER: Well you've articulated well Commissioner, what some of the benefits are of joint ownership. I've seen multiple examples. I was talking to Mr. Ratcliffe earlier just down in Georgia, the integrated transmission system down there with Georgia Power and our members is a good example of how that works.

In terms of how can we facilitate that, I think, you know, continually encouraging it that that happen because it does provide those benefits both up front and after the fact.

There is, you know, typically less dispute after the fact when you have that joint ownership arrangement, and so it has benefits up front in planning and jointly meeting each other's needs. It has the benefit as you mentioned, of jointly advocating and showing a broad range of support for those needed facilities and after the facts folks get along well in those facilities.

Operator West has had numerous examples of those and so just, you know, whatever the Commission can do and stating its desire to see that where it may happen, looking at individual dockets as they occur for opportunities, again, where that might be encouraged.

MR. RATCLIFFE: I would just add that in the State of Georgia, as Jeff said, we had a long history of probably 30 years of joint ownership of both the transmission system and certain generating assets with public power entities and it has served us very well. It certainly helps to carry the load. You do have mutual planning to the benefit of everybody and get support across the state for these things.

I would also add that the planned addition that I mentioned in my remarks with regard to hopefully the next nuclear plant built in this country would be a co-owned facility also.

MR. STERBA: I would just add one thing. I mean, we certainly have many jointly owned facilities both transmission and generation. It's kind of the way the west grew up.

I found on the transmission side frankly, they work very well. On the generation side, there can be challenges. We've got one project that's got seven owners, and someone's got to operate it. Someone's got to make a decision about when it's coming down and the maintenance.

If you've got an operating agent, but you can also have issues where a set of participants don't want to go forward with a certain investment. So there are challenges sometimes on the generation side, again an improvement investment.

One of the ways that we found to work around that is to take base load facilities owned by ourselves and another party and exchange interest for the purpose of operating. So we end up sharing reserves, so we make the hazard for each of us to look like half of what we had before. But we own title and interest in the original facility.

So we maintain clarity of legal control but we get the benefit of the sharing of the hazard. So I think there are a number of ways that you can do it and frankly, by and large we've had great success. There are few times when, particularly upon non base load resources where you can have some difficulty.

COMMISSIONER SPITZER: Mr. Shelk, in terms of base load generation, the current economic environment is a little tenuous in the non RTO regions. What would be your general prescription for improving that?

MR. SHELK: I think the whole area of procurement that you are going to lead with --. I think is an important area to look into. I think the question is not being able to finance this on a non-rate base basis. So that's kind of one of the myths that's put out.

I mean, from our conversations and my meetings with the folks at NARUC, there is a great deal of interest in doing that, but you can't, in some cases, if you have nobody to serve, nobody is going to finance the project. So that's where I think the whole area of trying to come up with rules to make it more transparent, to have the people, if at the end of the day the IOU project or rate based project makes the most sense, then it should go forward.

But the idea that in most states there are no rules in effect and when they are in effect exemptions are being sought, now that makes it difficult for there to be a viable wholesale market in those areas, absent those opportunities.

And we hope that the work that you're going to do with NARUC will shed a great deal of light on what the best practices might be in terms of the rule.

Some states have good rules. What has happened in Colorado, the terms of the project, the terms of the offer get changed after people have relied on it. As Commissioner Wellinghoff state, there was a private project available but they were totally excluded from the proceeding.

So it's those types of things happening that the bilateral markets are not providing a fair opportunity for competitive suppliers and absent those opportunities, the policy of wholesale competition will not be fully implemented.

COMMISSIONER SPITZER: Thank you Mr. Chairman.

CHAIRMAN KELLIHER: Thank you. Jon.

MR. WELLINGHOFF: Mr. Chairman, thank you. It may be advantageous to be the last presenter and the last panel it's probably not advantageous to be the last Commission with the last question.

(Laughter.)

So I'm going to make it very short, if I can. I have a question for Mr. Sterba. You actually intrigued me Mr. Sterba with the comment you made about renewables and I'd just like to follow up on it a little bit and maybe you can expand upon it.

I believe you indicated that you thought it would be good for FERC to help create markets for trading in RECS and I was wondering if you were thinking there of both bilateral and organized markets and if you had anything you wanted to expand on.

MR. STERBA: I am. In the west, we have developed this and we're still developing a system to reach a system, to be able to track so people know where the REC came from and verify its authenticity, etcetera.

But I think if we can help get the states out of the mind set that the only renewable is the one located in their state, and help show the value of creating a robust market for both the renewable energy and the REC, and I think that the FERC is in a position to help facilitate that.

And so I am talking about an open trading market. Today --

MR. WELLINGHOFF: That would be -- I'm sorry -- and that would be even between organized markets and the bilateral market areas?

MR. STERBA: Absolutely. Today, I mean we have bilateral arrangements under which they are bought and sold. We don't necessarily have a clearinghouse, so it's really OTC. I can see that being facilitated by a more organized market. But we now have states, you know, across the country that are putting in place renewables portfolio standards and it just makes sense to me to make that market as liquid as possible.

MR. WELLINGHOFF: Thank you. I have no further questions.

CHAIRMAN KELLIHER: Very impressive time management, I have to say.

(Laughter.)

It puts the burden on me to be equally efficient. Let me try. I'd like to follow up on a couple questions.

My colleagues have covered most of the ground that I wanted to cover. But I agree with some of the comments that we are dealing with different market structures and really strengths and weaknesses, different strengths and weaknesses in each of these structures.

It does seem in the bilateral markets they have done, southeast has done a very good job on investing in transmission and I can't say I understand why fully. I realize one difference between -- and I'm curious why -- but there is one difference between the southeast and other parts of the country it seems, transmission ownership is a little more concentrated in the southeast and other parts of the country it's really fractured.

So perhaps that's an advantage, that if you have a certain scale and a certain large regional footprint, it's easier. Other states -- your company is a multi-state system and other parts of the country there is really an instinctive dislike at the state level to site a project that actually might benefit the neighboring state to some extent.

Since your system is multi-state, that may not be as much of an issue in your states. How have you been able to make that kind of investment and get solely cited? Is it scope, is it concentration, is it support of state regulation t hat presumably is a factor?

MR. KERR: I was going to say quality regulation.

(Laughter.)

CHAIRMAN KELLIHER: Quality, regulatory certainty, or is I cost allocation? I'm curious, when you make a major investment in transmission, you don't have an affiliated transmission company, it's owned by the various operating companies, but it might benefit a neighbor.

Georgia Power might build a facility, it might benefit Alabama Power. How do you allocate those costs?

MR. RATCLIFFE: Well I think it goes to all the -- coupe of the topics that you identified. First of all, we've enjoyed significant continued growth in the southeast, which gives us an opportunity to expand. We do system planning for resources, so we're looking at how do we strengthen the entire network and where do we need to add resources for the benefit of the entire system.

When you operate the kind of system that we operate, the size system we operate allows you to demonstrate those benefits across a much larger region. And I would be remiss if I didn't say it was very innovative and constructive regulation on behalf of the FERC.

(Laughter.)

CHAIRMAN KELLIHER: But it does seem -- I mean your state regulators must start off recognizing that you have an interstate grid and they're part of an interstate grid it's not divided.

MR. RATCLIFFE: And that they benefit from that from a reliability standpoint.

CHAIRMAN KELLIHER: And that's just a hurdle that other regions have not yet jumped over, it seems. But I was very surprised that your 28 percent number. I think that was a Georgia Power number, not a southern company number, right? That Georgia Power buys 28 percent of its power?

MR. RATCLIFFE: It's about 30 percent. That was a commission target that was implemented when we began the integrated resource planning process. They said they really didn't want to exceed about 30 percent of the purchased.

CHAIRMAN KELLIHER: That's from non affiliates or both affiliates and non affiliates?

MR. RATCLIFFE: Just purchased, both affiliates and non affiliates.

CHAIRMAN KELLIHER: Through competitive solicitation.

MR. RATCLIFFE: Yes.

CHAIRMAN KELLIHER: I mean there does seem one difference, it does seem perhaps harder to enter in the bilateral markets than in the RTO markets.

I'm not sure that's the case, that's certainly what the independents say, but it does seem that the continued entry by independents is necessary for us to have competitive markets. It seems the manner of entry is different though and the bilateral markets is typically going to be a competitive solicitation. That's the means of entry.

But if you actually win the competitive solicitation, you might get a 10 year contract, perhaps longer. I understand in California, you can currently sign longer than a 10-year contract?

MS. SCHORI: Yes.

CHAIRMAN KELLIHER: So the reward might be greater if you have successful entry in the bilateral markets verses the RTO markets.

MR. RATCLIFFE: Just to comment about that. It's hard for me to see and appreciate the difficulty when you look at 8 years and over 200 proposals for 160,000 megawatts that this problem and participating in this market.

CHAIRMAN KELLIHER: In SERC, yes.

MR. RATCLIFFE: It's a Georgia process.

CHAIRMAN KELLIHER: It does seem that Georgia process is held up as a model and that's something I hope the competitive stations will look at is really what are the best practices at the state level for good competitive solicitation and if states can voluntarily move toward best practices, we might see greater assurance of entry.

MR. SHELK: If I could just quickly comment. As

I indicated, Georgia has very good rules. There are two problems. One is as I indicated, they just file to exempt all base load nuclear from those rules.

So I think the numbers will likely change and you have to ask the question, if the rules are so good, the process was so good, you know, why seek the exemption?

The other thing that happened in Georgia, the rules were good, but then they went and try to say that the competitive bid would be affected by the purported computed debt from the purchase power agreement, and to the credit of the Georgia staff and to the Commission, they agree with us that that was not a proper way to use computed debt to put kind of a finger on the scale against the competitive supplier and they withdrew the case from the Georgia Commission before it became a precedent of the Commission.

So we've publicly said and we look forward to working with Chairman or Commissioner Wise on this. The rules are good but again if the rules are not followed, if exemptions are sought, if computed debt is used as a way to tip the scales, then all the good rules don't really amount to a fair market opportunity and we think those are the kind of best practices, or as someone said earlier, dos and don'ts that hopefully Commissioner Spitzer and the others on the Task Force will look at.

Because we think some of these things, when they come to the light of day, will be seen for what they are as a way to tilt the scales and hopefully we can right that so the opportunities are there that we all think should be there for competitive suppliers.

CHAIRMAN KELLIHER: Yes, Jeff.

MR. STERBA: Mr. Chairman I'm sorry and certainly this should not become a discussion about imputed debt. But I just, having to finance a balance sheet, to say that purchase power, long-term purchase power under take or pay contracts does not have a debt component that has to be addressed and borne somewhere, I just have to say that's not correct.

It's not the debate of today, but to say that there isn't an issue there, when we talk, whether it's on the transmission side or the generation side, I just want to say I have a different opinion.

CHAIRMAN KELLIHER: You think it has to have some weight?

MR. STERBA: I believe it does. But the question is, when you acquire that resource and it is effectively going to be treated as debt by the rating agency, then in another proceeding, you are going to have to thicken your equity.

So where do you associate the cost? The cost causation is the transaction that you've entered into. It affects cost of capital, which may be another proceeding but I think to say there is no cost causation, by entering into the power contract, is not, not quite correct.

MR. KERR: Let me just mention one thing. Being the state regulator in this part of the discussion, let me just mention a couple of things.

I think it would be, you know, base load is different. There is a need to know that it is there. I think there are issues around security of supply that are valid and that I would expect our Commission and other Commissions to want to have some level of certainty around the contractual issues and quite simply when it's built and it's in right place and it's in the ground, you do sleep a little better at night.

And so I think best practice is working through these issues, I mean whether we will get all of this done, but those are the types of things. I mean I think we, Georgia does a good job in the southeast, North Carolina's approach, quite frankly has been less formal, a little bit inconsistent.

And so the idea is to adopt best practices, but also hash out some of these type of concerns that I would think my colleagues would share.

I will say this though, as there are various efforts to shift more and more of the risk of construction of base load projects on to rate payers. I call it a reallocation and someone corrected me and said no, it's not a reallocation, it's a realignment. I'm not quite sure I know the difference.

But it's different than it has been and the companies have traditionally held the risk of need or prudence until a later point in time and it is now their various efforts in my legislature and other places to shift that risk to rate payers.

As a rational regulator, I promise you I'm going to care more about other ways I can lay off that risk and if Jon's got members who want to take that risk, now I think there are challenges, if they can do it as cost-effectively and find the financing, but I promise you I'm more interested, the more risk that are being shifted onto the rate payer.

And so I do think you're going to see people being more and more interested in competitive procurement as a way to lay off some of that risk, or possibly lay off some of that risk, potentially lay off some of that risk that's being shifted onto the rate payers early in the process.

CHAIRMAN KELLIHER: I just have a quick question for Jon. I just want to make it clear that you said that in a competitive solicitation you think utility self-built or even affiliate bid should be allowed, it should be in the mix?

MR. SHELK: They could be. The problem is making sure who is the decision maker because this often happens. They get to decide. There are actually even instances which I hope the Task Force would look at where they are able to look at the bids from others and then rebid their own affiliate.

I mean I've heard that story and those complaints and those are the kinds of things we'd like to have the Task Force look at. It's independent decision maker, that's one.

CHAIRMAN KELLIHER: I'm not being as efficient as Jon, I'll try to make just two quick comments. One that actually will be a question. For transparency, there has been a lot of discussion of transparency an advantage of say the organized markets. But you can have transparency outside the RTO structure. You have it in the west, you have very good pricing hubs in the west, it's the hubs in t he south seems to have less liquidity and they're, you know, not the same volume of transactions.

I'm not sure what we can do about that. We don't really regulate the hubs, I'm just not sure what actions we can take to have greater price transparency in the south. We can, you know, encourage the development of these hubs, but we can't compel them, to my knowledge.

Does anyone have any great ideas on what we can do to provide more transparency in the south, similar to what we have currently in the west. No.

MR. RATCLIFFE: Mr. Chairman I don't have an immediate response. I would be glad to work with you to try to accommodate that.

CHAIRMAN KELLIHER: Sure. Thank you I'm just curious. And my last comment, I'll make one last comment and make some brief wrap up. Jan, go ahead.

MS. SCHORI: I just wanted to add that the ice platform that we are using in the west is actually a national platform. They trade gas, they trade oil and they trade power and they may trade other stuff, I haven't looked today.

(Laughter.)

So that actually is available as a tool for those who want to use it.

CHAIRMAN KELLIHER: Thank you. Now we've had a lot of discussion today about cost or market, you know, people, there seems to be an understandable desire by sellers to be able to move to the lower of cost or market and I can understand that desire. I'm sorry, buyers to go to the lower of cost or market, sellers to go to the higher of cost or market.

But that's not a very workable market if you have that constant search by both the buyers and sellers. I just think we have to have some level of consistency if we're going to build on competition to some extent, we have to rely on market prices. And the sellers and buyers shouldn't be able to freely move between the two worlds. We don't end up with very workable market in the end.

And I think this has been a very good conference and I want to thank these panelists, as well as the earlier panelists. I think we've heard a lot today. I'm glad there is not a fourth panel, I have to say.

(Laughter.)

But I think right now the next steps would be for the Commission to kind of look through the record of this proceeding, get some suggestions from staff on how we should organize future conferences because there is more than one way we could organize ourselves and so let's figure out -- and I won't speculate different ways we can organize ourselves.

(Laughter.)

But I think we should get some suggestions from staff and then the five of us should work together on how we want to structure remaining conferences. But this is not a one day matter. We are going to -- this will continue. But thank you very much everyone for helping us today.

AUDIENCE: Thank you.

(Whereupon, the meeting was adjourned at 4:27 p.m.)